Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Review of Regulatory Requirements	)	CC Docket No. 01-337
Incumbent LEC Broadband	)	
Telecommunications Services	)	

COMMENTS OF SBC COMMUNICATIONS INC.

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SBC Communications Inc. (SBC), on its own behalf and on behalf of its affiliates, files these comments in response to the Notice of Proposed Rulemaking, released December 20, 2001, to consider what Title II regulations, if any, should apply to incumbent local exchange carrier (LEC) broadband telecommunications services.[1]

The Commission should take decisive action to remove dominant carrier regulation of incumbent LEC broadband services that is both unnecessary and harmful to competition and broadband deployment. As SBC demonstrated in its Petition for Expedited Ruling That it is Non-Dominant In Its Provision of Advanced Services and for Forbearance From Dominant Carrier Regulation of Those Services (Non-Dominant Petition), there is overwhelming evidence of substantial competition in the broadband market.[2] Indeed, far from being dominant in the provision of broadband services, incumbent LECs are dwarfed by larger facilities-based competitors in both the mass market and larger business segments of the broadband market. Moreover, rapid technological change and the ongoing convergence of wireline telephone, cable, wireless, and satellite broadband services will ensure that incumbent LECs do not acquire market power.

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[1] *In the Matter of Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, *Notice of Proposed Rulemaking*, FCC 01-360 (rel. Dec. 20, 2001) (*NPRM*).

[2] A copy of SBC's Non-Dominant Petition, including the Declaration of Robert W. Crandall and J. Gregory Sidak *(Crandall/Sidak Declaration)* is attached to these comments. Although SBC used the term "advanced services" in the Non-Dominant Petition to reflect the Commission's terminology, SBC will follow the Commission's lead and use the term "broadband services" in its comments.

Continuing to single out incumbent LECs for dominant carrier regulation in these circumstances is indefensible. Not only is dominant carrier regulation unnecessary, but it also is distorting competition and impeding broadband investment and deployment. SBC urges the Commission to unleash the power of the market and declare incumbent LECs non-dominant in the provision of broadband services to mass market customers (*e.g.*, high-speed Internet access) and broadband services that enable larger business customers to transmit and route packetized data. In addition, the Commission should extend non-dominant treatment to future services and technologies that are introduced into the broadband market. Removing this unnecessary regulation will produce significant benefits for customers, including lower prices and greater innovation and investment in the broadband market. As Chairman Powell stated, "the beauty of market mechanisms [as opposed to government regulation] has always been that the give and take among competitors and consumers produces an optimal set of terms and conditions."[3]

I. Introduction and Summary

This proceeding is just one of the major proceedings recently initiated by the Commission that have enormous implications for the future of broadband competition and investment. As market conditions in the telecommunications and information and technology sectors continue to stagnate, or worse, deteriorate, the need for rapid Commission action to remove regulatory barriers to broadband deployment becomes even more urgent. There is a broad consensus that the elimination of regulation is one of the easiest and most effective ways to promote competition and investment in the deployment of broadband infrastructure. In January, for example, the Technology Network (TechNet), a national network of CEOs from leading technology companies, such as Cisco and Intel, called on the Commission and other

[3] *See* Chairman Powell's Separate Statement in *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and American Online, Inc., Transferors, to AOL Time Warner Inc., Transferee*, CS Docket No. 00-30, *Memorandum Opinion and Order*, 16 FCC Rcd. 6547(2001) (*AOL/Time Warner Merger Order*).

policymakers to remove roadblocks to broadband deployment and establish a national broadband policy.[4] TechNet identified a number of principles that should guide this national policy, including minimal regulation of broadband services and the removal of regulatory uncertainty and disincentives to broadband deployment.[5] A group of well-known economists also have called on the Administration, in light of the current economic slowdown, to take aggressive action to eliminate disincentives to broadband investment by accelerating deregulation as rapidly as possible.[6]

The Commission has an important opportunity in the various proceedings it has initiated to chart a new course and overhaul the outdated regulatory framework that is hindering broadband deployment. In the same way that the new broadband networks deployed by the incumbent LECs have evolved far beyond the legacy circuit-switched network, so too must the Commission's regulatory framework for broadband evolve beyond the legacy regulations of the past. The current regulatory regime that subjects one class of providers — incumbent LECs — to burdensome regulations and ongoing uncertainty, while leaving other competitors wholly unregulated, distorts competition in the market and reduces incumbent LEC incentives to invest in broadband networks and services.

Chairman Powell recently observed that "broadband deployment is the central communications policy objective in America."[7] A new regulatory framework that is conducive

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4 Press Release, *TechNet CEOs Call for National Broadband Policy* (rel. Jan. 15, 2002).

5 *Id.*

6 *See* letter from Robert Crandall, George Gilder, Lawrence Kudlow, William A. Niskanen, Jeffrey E. Eisenach, Thomas W. Hazlett, James C. Miller III and Alan Reynolds to Donald L. Evans, Secretary of the U.S. Department of Commerce, Lawrence Lindsay, White House Adviser, Glenn Hubbard, Council of Economic Advisers, and Paul H. O'Neill, Secretary of the U.S. Department of Treasury (Dec. 4, 2001).

7 *In the Matter of Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities; Universal Service Obligations of Broadband Providers; and Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review – Review of Computer III and ONA Safeguards and Requirements*,

to broadband investment and facilities-based competition is essential to achieving this objective and fulfilling the promise of broadband services. But will not be easy to overcome the technical and financial hurdles facing broadband deployment. To eliminate these hurdles, the Commission's regulation of the broadband market should be based on the following three bedrock principles: (i) regulators should take a "hands-off" approach to the broadband market; (ii) broadband regulation must be competitively and technologically neutral; and (iii) broadband regulation should provide regulatory certainty across all jurisdictions. A comprehensive regulatory framework that is consistent with these principles will stimulate investment in broadband networks and unleash facilities-based competition and the power of the free market.

The Commission suggests that removing dominant carrier regulation of incumbent LEC broadband telecommunications services is a challenging step.[8] Actually, deregulation of the incumbent LECs' broadband services should be a much *easier* case than prior proceedings. Unlike the *AT&T Reclassification* proceeding, this proceeding does not involve a formerly dominant carrier that has been gradually losing market share over time. The broadband market is a nascent market in which the incumbent LECs are not incumbents at all and have never been dominant. And, unlike the proceeding to consider the Bell Operating Companies' (BOCs) entry into the long distance market, this proceeding does not involve a speculative determination by the Commission about whether a carrier that is considered dominant in one market will be able to acquire market power in a related market.[9] The incumbent LECs have been competing in the broadband services market for years and have not come close to acquiring market power. In fact, SBC's broadband affiliate actually operated as a non-dominant provider for 18 months, and,

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CC Docket Nos. 02-33, 95-20, and 98-10, *Notice of Proposed Rulemaking,* FCC 02-42, (rel. Feb. 15, 2002) (*Title I NPRM)*. (Chairman Powell's Separate Statement).

[8] *NPRM*, ¶ 6.

[9] *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace,* 12 FCC Rcd 15756 at ¶ 96 (1997) (*BOC Classification Order).*

during that time, it did not acquire market share in either the larger business or the mass-market segment.

Nor, as the Commission suggests, is there anything novel about deregulating a carrier in the provision of a particular service or services. Congress expressly granted the Commission the authority to forbear from regulation with respect to individual services, as well as individual carriers.[10] Further, this would not be the first occasion in which the Commission has classified an otherwise "dominant" carrier as non-dominant in the provision of particular services. In the *LEC Classification Order,* the Commission ruled that independent LECs were non-dominant in the provision of interLATA services, even though such carriers are not subject to section 272 separation requirements.[11] In addition, the Commission declared AT&T non-dominant in its provision of domestic interLATA services, even though AT&T was still classified as dominant in its provision of international services.[12] The Commission also has streamlined and reduced regulations of particular services offered by dominant carriers, just as it would be forbearing from regulating particular services in this proceeding.[13]

SBC's Non-Dominant Petition presented overwhelming evidence that the broadband services market is intensely competitive and that the incumbent LECs pose no threat to exercise or acquire market power. The primary broadband service purchased by mass-market customers today is high-speed Internet access. The incumbent LECs compete against facilities-based cable

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[10] 47 C.F.R. § 160(a).

[11] *In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services and Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket Nos. 96-149 and 96-61, *Order*, 12 FCC Rcd 15756 at ¶ 7 (1997) (*LEC Classification Order).*

[12] *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier,* 11 FCC Rcd 3271 at ¶ 2 (1995) (*AT&T Reclassification Order*).

[13] *See Competition in the Interstate Interexchange Marketplace***,** 6 FCC Rcd 5880 (1991) (*AT&T Streamlining Order*); *see also Access Charge Reform, et al.*, CC Docket No. 96-262, et al., Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221 (1999) (*Pricing Flexibility Order)*.

modem, satellite, and wireless competitors in the delivery of high-speed Internet access, and the DSL service offered by incumbent LECs has maintained a steady 30 percent market share. In stark contrast, unregulated cable companies enjoy a significant and growing lead in the availability of their cable modem services, a dominant position in the market — with twice as many cable modem customers as DSL customers — and a significant cost advantage in the deployment of cable modem service vis-à-vis DSL service.

The incumbent LECs' position in the market for broadband services to larger business customers is no different. Ever since packet-switched services were introduced in the early 1990s, the Commission has recognized that the market is highly competitive[14] and that the incumbent LECs were new entrants in the market.[15] Today, the market for broadband services, such as Frame Relay and ATM, continues to be dominated by the large interexchange carriers (IXCs). The "big three providers (AT&T, WorldCom and Sprint) collectively account for 70 percent of the market for these services nationwide, whereas the incumbent LECs account for only about 14 percent.[16] In addition to the packet-switched services identified in SBC's Non-Dominant Petition, there are a number of other services (*e.g.,* optical transport and "next generation" packetized transport services) that are integral to the transmission and routing of packetized data. Competition and technological advances are continuing to provide large business customers with ever-increasing options in the market to meet their data needs.

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14 *Open Network Architecture Tariffs of Bell Operating Companies*, Order, 9 FCC Rcd 440 at ¶ 68 (1993) (emphasis added); *see also Southwestern Bell Telephone Company; Non-Dominant Petition for Waiver of Section 64.702 of the Commission's Rules and Regulation to Provide and Market Asynchronous Conversion on an Unseparated Basis,* 5 FCC Rcd 161, at ¶ 19 (1990) (finding that detailed cost support rules of 61.38 should not apply to Southwestern Bell's MicroLink II packet switching service, because "Southwestern entered the [packet switching] market with a zero share of the business and strong established competitors.")

15 *Bell South Corporation on Behalf of Southern Bell Telephone and Telegraph Company, Non-Dominant Petition for Waiver of Section 64.702 of the Commission's Rules and Regulations To Authorize Protocol Conversion Offerings*, 3 FCC Rcd 6961, at ¶ 9 (1988) (emphasis added).

16 *Crandall/Sidak Declaration* at ¶¶ 110-12.

It is equally evident that the incumbent LECs could not quickly acquire market power through discrimination or by raising their rivals' costs. In the mass-market context, the incumbent LECs' largest competitors — cable modem service providers — do not rely on inputs or facilities from the incumbent LECs. Likewise, the incumbent LECs' large competitors in the larger business market segment typically have their own end-to-end networks that are much more extensive than the incumbent LEC's. Further, as the Commission has recognized, the presence of price cap regulation of the incumbent LECs' access services constrains their ability to gain a competitive advantage by discriminating or raising their rivals' costs.[17] The fact that the incumbent LECs continue to lag behind their competitors in both segments of the broadband services market is proof that the incumbent LECs have no ability to quickly gain market power.

Above and beyond the compelling evidence of existing competition in all areas of the broadband market, the unique technical and competitive characteristics of the market obviate the need for dominant carrier regulation. Regulation of broadband services is not a "one-wire" issue, as it was in the historic market for circuit-switched voice services.[18] Rather, as the Commission acknowledges in the *NPRM*, the broadband services provided by different networks "are converging, as cable providers, satellite providers, and terrestrial wireless network providers develop new services that are becoming increasingly substitutable for the broadband services provided over the traditional telephone network."[19] These competing broadband platforms are unleashing the power of "creative destruction" in the form of near constant disruptive technological changes in the market.[20] The Commission should adopt a flexible non-dominance framework that is consistent with this market reality and the evolving broadband services

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17 *BOC Classification Order,* at ¶125.

18 *NPRM*, at ¶ 5.

19 *Id.*, at ¶ 4.

20 Michael K. Powell, Commissioner, Federal Communications Commission, Address before The Progress & Freedom Foundation *The Great Digital Broadband Migration* (Dec. 8, 2000) (Powell, Broadband Migration Speech).

market. In particular, it should be forward looking and extend non-dominant treatment to all future broadband services and successor technologies, not just existing services and technologies.

Removing unnecessary Title II tariff and pricing regulation of broadband services is an important first step in promoting broadband competition and deployment. Section 706 mandates that the Commission "encourage the deployment . . . of broadband telecommunications capability to all Americans" through regulatory forbearance and other measures that "remove barriers to infrastructure investment."[21] In adopting section 706, Congress established a clear national policy that favors unfettered competition in the market, as opposed to government regulation, as the primary mechanism for promoting broadband deployment. This congressional directive would be rendered meaningless if the Commission does not take the modest step of removing dominant carrier regulations that are completely unnecessary and harmful to competition and investment in the broadband market

But the Commission can and should do much more than eliminate dominant carrier regulation of broadband services. It also must eliminate the threat of "regulatory creep" in the *Triennial Review* proceeding by keeping broadband networks free of unbundling requirements that were designed for the legacy narrowband telephone network.[22] In addition, the Commission must establish consistent rules for competing broadband "information services," whether they are provided over a cable television network or a wireline telephone network, in the pending *Cable Modem*[23] and *Broadband Title I* proceedings.[24] For example, the incumbent LECs must

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21 *NPRM*, at ¶ 40; 47 U.S.C. § 157 nt.

22 *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-339, 96-98, and 98-147, *Notice of Proposed Rulemaking*, FCC 01-316 (rel. December 20, 2001) (*UNE Triennial Review NPRM*).

23 *Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilitites*, GN Docket No. 00-185, *Notice of Inquiry*, 15 FCC Rcd 19287 (2000) (*Cable NOI)*.

have the same ability as their facilities-based competitors to bundle broadband transmission services with content and other information service functionalities. The broadband goals of the Act will be realized only if regulation does not constrain broadband investment, efficient use and design of broadband networks, the creation of new services and technologies, and the packaging and pricing of broadband services.

II. Analytical Framework

A. Definition of Dominance and Non-Dominance.

The Commission defines a dominant carrier as "a carrier that possesses market power" and a non-dominant carrier as "a carrier not found to be dominant (that is, one that does not possess market power.)"[25] The Commission has held that, for purposes of this analysis, market power is the "ability to raise and maintain prices above competitive levels without driving away so many customers as to make the increase unprofitable."[26]

In so holding, the Commission specifically rejected the notion that a BOC affiliate should be treated as dominant in the provision of a service simply because it might derive some advantages over its competitors by virtue of its affiliation with the BOC. Agreeing with the Department of Justice, the Commission held that dominant carrier regulation was designed to prevent the affiliate from raising its prices by restricting its output, and that dominant carrier regulation was "at best a clumsy tool for controlling vertical leveraging" by the BOC itself.[27] Moreover, the Commission noted that "regulations associated with dominant carrier classification can … have undesirable effects on competition."[28] Accordingly, the Commission

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24 *Title I NPRM,* ¶ 8.

25 47 CFR §§ 61.3(q), 61(y).

26 Fourth Report and Order, *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor,* 95 FCC 2d 554 at ¶ 7 (1983); *BOC Classification Order* at ¶ 85.

27 *BOC Classification Order* at ¶¶ 85, 91.

28 *Id.,* at ¶ 90.

does not treat a carrier as dominant in the provision of a service unless the carrier can raise the market price of that service by restricting its output. It does not, as Crandall and Sidak point out, "impose dominant carrier status simply to ensure what some refer to as a 'level playing field.'"[29] If it has concerns about leveraging of market power in particular services, it addresses those concerns directly through its regulation of those services. SBC sees no basis for the Commission to depart from this established analytical framework in this proceeding.

B. Definition of Relevant Markets.

In order to assess market power, it is first necessary to define the relevant product and geographic markets.[30] As pointed out in the Non-Dominant Petition, since the *BOC Classification Order* in 1996, the Commission has followed the *Merger Guidelines*[31] in defining product and geographic markets.[32] Under those guidelines, product markets are defined primarily with reference to demand cross-elasticities. Specifically, two services are deemed to be in the same product market if a small but non-transitory price increase by a monopoly provider of one of these services would cause enough buyers to shift their purchases to the second service as to render the increase unprofitable.[33] Two geographic areas are in the same geographic market if a small, but non-transitory price increase for a service in one area would cause customers to switch to the same service offered at a lower price in the other area.[34]

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29 *See Crandall/Sidak Declaration* at ¶ 84.

30 *See BOC Classification Order* at ¶16.

31 United States Dept. of Justice Antitrust Div., and Federal Trade Commission, *1992 Horizontal Merger Guidelines,* 57 Fed. Reg. 41552 (1992) *(Merger Guidelines)*.

32 *See BOC Classification Order,* at ¶ 26 (adopting guidelines). *See also e.g., Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.,* 13 FCC Rcd 18025 at ¶¶ 24-31 (1998) (applying guidelines) (*WorldCom/MCI Merger Order*).

33 *See also BOC Classification Order*, at ¶ 28; *Crandall/Sidak Declaration,* at ¶ 32. *Merger Guidelines,* § 1.0.

34 *BOC Classification Order,* at ¶ 28.

Although the Commission defines product markets primarily with reference to demand elasticity, the Commission has held, consistent with the *Merger Guidelines,* that if "production substitution among a group of products is nearly universal among the firms selling one or more of those products," it may consider that group of products to be in the same product market. In other words, if the facilities of most competitors are capable of providing a group of services, those services may be considered, for purposes of administrative convenience, to be in the same product market.[35]

The Commission has recognized that it may not be practicable to identify and analyze every single product and geographic market in a particular regulatory proceeding.[36] Accordingly, for purposes of assessing market power, it will conduct a separate analysis for two different services or two different geographic areas only if there is credible evidence that there is or could be a lack of competitive performance with respect to one of those services or areas.[37] Once again, the Commission has no basis to depart from its established analytical framework in this proceeding.

C. Framework for Assessing Market Power.

The Commission has generally looked at four factors in determining whether a carrier has market power in the provision of a service: (1) market share and changes therein; (2) demand elasticity; (3) supply elasticity; and (4) disparities in size, resources, financial strength, and cost structures among the market participants.[38] With respect to the fourth factor, the Commission has repeatedly held that the focus of its inquiry is not on whether the firm at issue has certain

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35 *WorldCom/MCI Merger Order*, at ¶ 27.

36 *BOC Classification Order,* at ¶¶ 31 and 56.

37 *Id*., at ¶¶ 42-43.

38 *See AT&T Reclassification Order*; *Competition in the Interstate Interexchange Marketplace,* 6 FCC Rcd 5880 (1991), (*AT&T Streamlining Order*). *See also COMSAT Corp. Petition Pursuant to Section 10(c) of the Communications Act of 1934, as amended, for Forbearance From Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier,* 13 FCC Rcd 14083 (1998).

advantages in the relevant market, but "whether any such advantages are so great to preclude the effective functioning of a competitive market."[39]

In the *BOC Classification Order,* the Commission added to this test. The Commission readily concluded that the BOC long-distance affiliates would not have market power when they first entered the long-distance market. Theorizing, though, that this initial lack of market power might merely reflect the fact that the BOCs had previously been excluded from the market, the Commission went on to address whether, "upon entry or shortly thereafter,"[40] the BOC affiliates could acquire market power by leveraging any market power of the operating company.

This additional inquiry is superfluous with respect to the incumbent LECs' broadband services. The incumbent LECs are not new entrants in the broadband services market; they have been providing DSL service for use by mass-market customers for at least two years, and they have been providing broadband services to larger business customers for far longer. Thus the Commission need not speculate on whether an incumbent LEC could "upon entry or soon thereafter" acquire market power in these services; in two-plus years, it has not done so. In fact, as shown below, it has not even come close. Nevertheless, out of an abundance of caution, SBC demonstrates, not only that the incumbent LECs currently lack market power in its provision of broadband services, but also that they could not quickly acquire market power.

D. A Flexible Non-Dominance Framework is Needed for the Evolving Broadband Services Market.

The Commission must establish a flexible non-dominance framework that will accommodate the rapid evolution of the broadband services market. In the *NPRM*, the Commission uses the terms "broadband telecommunications service" and "broadband service" to refer generally to high-speed telecommunications services used in the provision of broadband

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39 *AT&T Reclassification Order*, at ¶ 73; *AT&T Streamlining Order*, n. 187.

40 *BOC Classification Order,* at ¶ 96.

services.[41] Although the Commission indicates that it will consider the precise definition of broadband services in the recently initiated Title I *NPRM* proceeding,[42] it must recognize that the two proceedings are inextricably linked. The Commission should not lose sight of the fact that the real product market for broadband services is often not a telecommunications service at all, but rather an information service that includes content or some type of computing functionality. For example, a mass-market customer may purchase DSL service to obtain connectivity for high-speed Internet access.

SBC believes many broadband services currently are offered as telecommunications services only because of the Commission's requirement that wireline telephone companies must offer the telecommunications component of information services on a stand-alone basis.[43] Notably, cable companies and other facilities-based competitors in the broadband market are not subject to this burdensome requirement. This is becoming increasingly evident as new broadband technologies offer the potential to integrate transmission and content. To some extent, therefore, defining the product market for broadband services in the context of this Title II proceeding is an artificial construct that does not tell the whole story and is not meaningful to the customer. In determining the relevant product markets, the Commission cannot focus exclusively on broadband telecommunications services and the telecommunications component of broadband information services. Instead, the product market for broadband services must be defined by looking at the actual service that is purchased by the customer, which may be either a

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41 *NPRM,* n.2

42 *Title I NPRM,* ¶ 8.

43 *See, e.g.*, *Policy and Rules Concerning the Interstate, Interexchange Marketplace et al.*, CC Docket Nos. 96-61 and 98-183, Report and Order, FCC 01-98, at ¶ 40 (rel. Mar. 30, 2001) (*CPE Bundling Order*) (*citing Amendment of Section 64.702 of the Commission's Rules and Regulations*, CC Docket No. 20828, Final Decision, 77 FCC 2d. 384 (1980) (*Computer II Order*), *recon*. 84 FCC 2d. 50 (1980), *further recon*. 88 FCC Rcd 512 (1981), *aff'd sub nom.*, *Computer and Communications Indus. Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

broadband telecommunications service or an integrated broadband information service (*e.g.*, high-speed Internet access) that has a telecommunications component.

The Commission also must keep in mind that broadband services are provided using various technologies and platforms with certain common characteristics. As discussed below, the relevant product market for broadband transmission services includes a wide range of service offerings that are designed to provide mass-market and larger business customers with efficient, cost-effective, and reliable transmission of packetized data traffic. These services are capable of providing high-speed data transmission and are designed to provide connectivity for transmitting and routing packetized (*e.g.*, DSL, cable modem, Frame Relay, ATM and Ethernet) data.[44] In addition, these services rely on similar networks that operate independently of the public switched telephone network. As Chairman Powell has observed, the explosive growth of data traffic and the Internet is driving the rapid evolution of the network and a migration of traffic from the legacy telephone network to new digital broadband products and services.[45]

Moreover, the Commission cannot limit its definition of the broadband services market to existing services and technologies. The "digital broadband migration," as it has been called, is triggering intense competition and a flood of technological advances. As a result of these advances, the broadband services of today will be replaced by successor technologies that are not yet commercially available. For example, equipment manufacturers currently are developing switched optical network technologies (*e.g.*, Automatic Switched Optical Network)[46] that have

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[44] SBC uses the term "packetized data" to refer generally to data that is formatted as a packet, cell, or frame at the Data Link (Layer 2) or Network (Layer 3) layers of the network in the established OSI hierarchy of network layers.

[45] Powell, Broadband Migration Speech; Michael K. Powell, Chairman, Federal Communications Commission, Press Conference *Digital Broadband Migration – Part II* (Oct. 23, 2001).

[46] *See* International Telecommunication Union (ITU-T) Recommendation G.8080, *Architecture for the Automatic Switched Optical Network*, October 2001. *See also The Optical Internet: Architectures and Protocols for the Global Infrastructure of Tomorrow*, P. Bonenfant *et. al*, IEEE Communications Society Magazine, July 2001, pp. 152-159.

the potential to displace current broadband technologies such as ATM. Examples of past displacements of incumbent broadband technologies are the large-scale migration from X.25/X.75 packet-switched services to Frame Relay services in the 1990s and the continuing displacement of ISDN by DSL services for residential high-speed Internet access and business remote LAN access. Thus, SBC wholeheartedly agrees with the Commission's observation that it should avoid a narrow definition of broadband services that could result in an arbitrary or overly restrictive determination about the services that belong in the relevant product markets.[47]

To avoid placing artificial restraints on the development of the market, the Commission should define a broad category of new services and extend non-dominant treatment to all similar services. Once incumbent LECs are declared non-dominant in the broadband services market, they should not have to seek non-dominant treatment for each new service offering that may be introduced in the future. In the *Pricing Flexibility* proceeding for price cap LEC transport and special access services, the Commission adopted rules that require price cap LECs to demonstrate that a new service is eligible for pricing flexibility relief at the time the new service is incorporated into price caps in an Annual Price Cap Filing.[48] In order to avoid this type of procedure, which would be completely unworkable in the broadband market, Commission should ensure that its declaration of non-dominance in the broadband market is not limited to existing technologies or services.

III. Product Market Definition

The Commission defines markets primarily based on demand cross-elasticities. Because quantitative evidence of demand cross-elasticities between two services is often unavailable,

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47 *NPRM,* n.37.

48 47 C.F.R. § 69.701.

however, courts and the Commission have generally relied on qualitative evidence designed to elicit whether two services are "reasonably interchangeable" in their use.[49]

A. Broadband Services are Not Reasonably Interchangeable with Other Services.

The Commission has consistently recognized that broadband services comprise a discrete product market. The Commission first made this determination in the early 1990s, shortly after incumbent LECs began providing high-speed packet-switched services. The Commission recognized that, because packet switched services were provided over brand new networks, these services should be regulated differently than services provided over the legacy circuit-switched telephone network. Accordingly, the Commission held that "packet-switched services . . . should . . . be excluded" from the price-cap regulations that the Commission adopted for traditional incumbent LEC services.[50] The Commission also concluded that incumbent LECs should not be required to file detailed cost-support information for packet-switched services given that "[t]he packet switching services market is . . . highly competitive."[51] It likewise justified the decision not to investigate an incumbent LEC's packet switched rates on the fact that the incumbent LEC was "a new entrant in the *packet switching market*, which is currently dominated by a relatively small number of well-established service providers."[52]

Until very recently, broadband services were provided exclusively to business customers. In the late 1990s, however, several new technologies were introduced that for the first time enabled broadband services to be provided to mass-market consumers. As explained below,

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[49] *Crandall/Sidak Declaration,* at ¶ 34 (*citing Brown Shoe Co. v. United States,* 370 U.S. 294, 325 (1962), ABA Antitrust Section, Antitrust Law Developments 200 (3d ed. 1992).

[50] *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order*,* 5 FCC Rcd 6786, ¶ 195 (1990).

[51] *Open Network Architecture Tariffs of Bell Operating Companies*, Order, 9 FCC Rcd 440, ¶ 68 (1993) (emphasis added). *See* Non-Dominant Petition p. 16n.37.

[52] *Bell South Corporation on Behalf of Southern Bell Telephone and Telegraph Company, Petition for Waiver of Section 64.702 of the Commission's Rules and Regulations To Authorize Protocol Conversion Offerings*, 3 FCC Rcd 6961, ¶ 9 (1988) (emphasis added).

these new broadband services were designed primarily for broadband Internet access service. Consistent with its earlier determinations, the Commission found that the provision of these new broadband services should also be treated as a distinct relevant product market.[53] The Commission based this determination on the fact that these new services "include features unavailable" over conventional narrowband networks, "such as access to high-bandwidth content" and "always on" connections; that there are "high consumer costs involved in switching to high-speed platforms" compared to traditional services; and that "[p]reliminary quantitative studies indicate that narrowband and high-speed access services occupy separate markets."[54]

The Commission's consistent holding that broadband services are not reasonably interchangeable with other services is obviously correct. Customers use broadband services for very different purposes than other services, particularly those provided over the circuit-switched telephone network. In particular, they use broadband services primarily for high-speed data transmission.[55] Although it has recently become possible to provide virtually real-time voice communications over packet-switched networks, customers still overwhelmingly use these networks for transmitting stored data.[56] In contrast, the vast majority of revenue generated on circuit-switched networks still comes from the provision of voice services.[57]

The significant disparity in the way customers use broadband services and circuit-switched services reflects the fact that these services are provided using different network architectures with very different underlying technologies.[58] Broadband networks that transmit and route packetized data are much more efficient than circuit-switched networks for carrying

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53 *AOL/Time Warner Merger Order*, ¶ 69.

54 *Id.,* ¶¶ 69-71.

55 *See Crandall/Sidak Declaration*, ¶ 35.

56 *Id.,* ¶ 97.

57 *See* Non-Dominant Petition p. 17.

58 *Id.,* p. 18.

data traffic.[59] Moreover, broadband networks have other desirable features for data transmission — including enhanced network performance driven by highly developed error correction capabilities, flexible and dynamic reconfiguration and rapid connect times — that typically are unavailable with narrowband circuit-switched networks.[60]

B. Services Provided To Larger Businesses Are In A Separate Product Market From Those Provided To Mass Market Customers.

Just as the Commission distinguished between interLATA services provided to mass-market consumers and those provided to large business customers,[61] the Commission should acknowledge the same distinct product markets in the broadband services arena. In the broadband services market, larger business customers demand services with greater bandwidth, higher levels of reliability, higher levels of service and support, and higher levels of security; these services require network architectures and technologies that are entirely different from those used to provide mass-market broadband services.[62] The main broadband services currently provided to larger business customers are Frame Relay, ATM, and Ethernet; the main services provided for use by mass-market customers are DSL, cable modem, wireless, and satellite broadband Internet access.

Price is a differential too.[63] Typically, large business customers spend several thousands of dollars per month for broadband services, while the average broadband service marketed to mass-market consumers is around $50 per month.[64] Moreover, larger business customers enter into long-term contracts for service, generally acquired through a competitive-bidding process;[65]

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59 *Id*.

60 *Id*.

61 *WorldCom/MCI Merger Order*, at ¶ 26.

62 *See* Non-Dominant Petition, p. 20.

63 *Id*.

64 *See Crandall/Sidak Declaration*, at ¶ 100.

65 *Id.*, at ¶ 115.

whereas most mass-market customers of broadband services purchase their service on a monthly basis.

C. Broadband Services Provided To Mass Market Customers Represent A Discrete Product Market Without Relevant Sub-markets.

Broadband services for the mass-market segment are services that are capable of providing customers with transmission speeds in excess of 200 kbps in one direction and that typically are integrated with content or some other functionality of an information service. Currently, the primary broadband service purchased by mass-market customers is high-speed Internet access, but video services and other applications are also possible. There are at least four different technology platforms that are being used to provide mass-market customers with high-speed Internet access: DSL, cable modem, satellite, and wireless.[66]

SBC has already shown that there is broad consensus that broadband services for mass-market use belong to a discrete product market, citing to Department of Justice, Federal Trade Commission, and academic sources.[67] SBC also cited the Commission's own rulings and opinions. For example, in the *First Broadband Services Report,* the Commission observed that competitors employing different platforms would provide inter-modal competition in the consumer broadband market.[68] Likewise, in its 2000 Report to Congress on the status of competition in the market for video programming, the Commission stated: "[A]lthough wireless

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[66] As shown in the Non-Dominant Petition, in addition to providing high-speed access to an Internet service provider's point of presence, cable-modem service providers are also providing high-speed access to information stored in databases outside the Internet. *See* Non-Dominant Petition, pp. 20-21.

[67] *See* Non-Dominant Petition, pp. 21-22.

[68] *In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, *Report*, 14 FCC Rcd 2398, & 48 (1999) (*First Broadband Services Report*).

and satellite broadband technologies continue to be deployed, telephone company DSL technologies remain the most significant competitors to Internet over cable."[69]

SBC also cited industry analysts who study the market and who have recognized that DSL and cable-modem services compete head to head in the same market,[70] and even SBC's competitors in the broadband services market (such as AT&T, WorldCom, and AOL-Time Warner), who agree that DSL and cable modem service are part of the same product market.[71]

As more fully demonstrated in the Non-Dominant Petition, this universally shared view — that broadband services for the mass market are all part of a single product market with no relevant sub-market — is correct because:

- from a functional standpoint, the broadband services are substantially similar regardless of platform or the way they are delivered and;
- consumers view these services as substitutes and;
- providers of mass-market broadband services view themselves as competitors.[72]

They are also priced similarly. In fact, they have to be similarly priced because of these three features. Because they are functionally similar and viewed as substitutable and competitive services, the price of one constrains the price of the others. SBC elaborated extensively on these points in its Non-Dominant Petition and it will not repeat those arguments here. Broadband services provided for use by mass-market customers are unquestionably "reasonably interchangeable" and thus part of a discrete and relevant product market.

In the *NPRM*, the Commission has asked for comment on "the willingness and ability of end users to purchase other broadband services as substitutes for an incumbent LEC's broadband

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69 Seventh Annual Report, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 16 FCC Rcd. 6005, at ¶ 51 (2001). *See also,* Non-Dominant Petition, *see* p. 22.

70 *See* Non-Dominant Petition, p 23.

71 *Id.,* pp. 23-24.

72 *Id*., pp. 25-28.

services."[73] By "willingness," SBC understands the Commission to be asking for comments on whether customers are willing to use platforms other than DSL to obtain high-speed access to the Internet. And, by "ability," SBC understands the Commission to be asking for comment on the comparative availability of alternative platforms.

The lopsided market share — cable-modem service versus DSL — is answer enough to the question of whether customers are willing to purchase other broadband services as substitutes for incumbent LEC services. In a market where two thirds of the customers access the Internet via cable modem service, there can be no doubt as to the willingness of mass-market customers to use that platform. In some locations — particularly in rural locations where satellite television service is practically ubiquitous — SBC expects that end-user customers could obtain broadband Internet access service from a satellite or wireless provider. Although satellite technologies still account for a relatively small share of the broadband Internet access market, they are ubiquitously available and growing rapidly.[74] For example, the Strategis Group predicts that the number of U.S. satellite subscribers will grow to more than four million by 2005.[75] To be sure, upload speeds for satellite broadband services are slow, but as Professors Janusz Ordover and Robert Willig have testified on behalf of AT&T, such concerns are "irrelevant to the vast majority of users, who, if they worry about speed at all, are primarily interested in fast download times and do not send significant amounts of information."[76] Moreover, many of the consumers to whom cable modem service is unavailable are likely users of satellite video service. Having already chosen a satellite-based service for video, these customers likely would be receptive to satellite service for their Internet access as well.

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73 *NPRM*, at ¶19.

74 *See* Crandall/Sidak Declaration,¶ 46.

75 *Id.*

76 Reply Comments of AT&T Corp. and MediaOne Group, Inc., CS Docket No. 99-251, Sept. 17, 1999, Declaration of Janusz A. Ordover and Robert D. Willig, ¶ 100.

As for ability, SBC discusses the ability of cable modem service providers to meet the demand of end-user customers in the section on supply elasticity below. In brief, market data shows that the reach of cable modem service, while not ubiquitous, exceeds the present reach of DSL service by a wide margin. Further, as discussed below, the same market data confirms that cable-modem service providers would be able to absorb SBC's present DSL customer base, as well as meet their own projected growth.

D. Broadband Services Provided To Larger Business Customers Represent A Discrete Product Market Without Relevant Sub-Markets.

Broadband services for larger business customers consist of various high-speed services that transmit and route packetized data. Historically, data traffic was carried over dedicated private line networks at speeds up to a DS1 level. As computer and information technology evolved, and the amount of data traffic exploded, the bandwidth needs of customers could no longer be met with "small pipes" and stand-alone private line networks. The need for greater bandwidth drove the development of "large pipes" (DS3 and SONET) that could accommodate large amounts of digital information. It also led to the development of new services that were designed to carry and manage large amounts of information more efficiently than existing private line services. In the early 1990s, packet-switched services were introduced that were designed to overcome many of the inefficiencies of the circuit-switched voice network. Soon after incumbent LECs began providing these services, the Commission recognized that, because packet-switched services were provided over brand new networks, these services should be regulated differently than services provided over the legacy circuit-switched telephone network.[77] The Commission also recognized that the incumbent LECs were new entrants in the packet switched market.[78]

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[77] *Open Network Architecture Tariffs of Bell Operating Companies*, Order, 9 FCC Rcd 440 (1993), ¶ 68 (emphasis added).

[78] *Bell South Corporation on Behalf of Southern Bell Telephone and Telegraph Company, Non-Dominant Petition for Waiver of Section 64.702 of the Commission's Rules and Regulations To Authorize Protocol Conversion Offerings*, 3 FCC Rcd 6961, ¶ 9 (1988) (emphasis added).

As part of its order approving the merger of SBC and Ameritech in 1999, the Commission required the joint company to offer broadband services (*i.e.*, advanced services) through a structurally separate affiliate.[79] Based on the service offerings that existed at the time, the Commission defined broadband services as services that are high capacity (more than 56 kbps) and packet switched. By operating pursuant to the structural separation requirements established by the Commission, SBC's broadband services affiliate was able to operate in the market as a non-dominant carrier. In January 2001, however, the D.C. Circuit held that SBC's broadband services affiliate should be deemed an incumbent LEC for purposes of the requirements of Section 251(c), which raised questions about its status as a non-dominant carrier.[80] SBC filed its Non-Dominant Petition to resolve these questions and demonstrate that it is non-dominant in the provision of broadband services, regardless of whether it maintains a structurally separate affiliate.

SBC's Non-Dominant Petition focused on existing packet-switched services that were being offered by SBC's broadband services affiliate. In particular, SBC included Frame Relay service, ATM service, and Gigabit Ethernet services in the larger business segment of the broadband services market. Although some services in this market are capable of carrying voice traffic, larger business customers use each of these services predominantly for the same basic function: to transmit data at high speeds between computers or networks of computers.[81] As a result, they are interchangeable from a functional standpoint.

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79 *Application of Ameritech Corp. and SBC Communications, Inc for Consent to Transfer Control of Corporations Holding Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95, and 101 of the Commission's Rules,* CC Docket No. 98-141, Memorandum Opinion and Order, 14 FCC Rcd 14712 (1999) (*Merger Order*).

80 *Association of Communications Enterprises v. FCC,* 235 F.3d 662 (D.C. Cir. 2001).

81 Non-Dominant Petition, p. 17; *See Crandall/Sidak Declaration,* ¶ 97.

The larger business broadband services that SBC specifically identified and described in the Non-Dominant Petition represent a significant segment, but by no means the entire complement, of larger business broadband services. There are other services — most notably optical transport service offerings (*i.e.*, above DS3) — that customers view as alternatives in the broadband market.[82] Unlike lower capacity transport services, optical transport service is used primarily in the provision of broadband services. Therefore, optical transport service that is purchased by a large business customer to transmit and route packetized data is part of the relevant product market.[83]

A typical example of a large business customer application would be use of a high-bandwidth, highly reliable optical transport service — provisioned over a dedicated SONET ring — to connect multiple data processing centers, help desks or branch offices. The customer would purchase a router or data switch at the connection point of each of the SONET ring drop points (or nodes) located at its premises. This customer-owned router or data switch would be connected to the dedicated SONET ring service to complete the customer's high-speed data network.

From the customer's perspective, the resulting configuration is no different than if SBC were providing the customer with a high-speed packet-switched service. Regardless of whether an incumbent LEC provides all the components of the packetized data network or just some of the components, the incumbent LEC's optical transport services must have the capability and necessary technical characteristics to support the customer's various high-capacity data transmission needs by transporting data in packetized form. Large business customers not only

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[82] A customer that purchases transport service that is DS3 or lower capacity is purchasing traditional electrical transport, although the traffic may be aggregated onto an optical facility (*e.g.*, SONET ring) for transport on the incumbent LEC's network.

[83] SBC recognizes that some percentage of optical transport is used by IXCs in the circuit-switched network.

want, but also demand the flexibility to choose how best to satisfy their broadband needs, and optical transport service is one of the substitutable services they purchase.

Due to the explosive growth of data traffic, the optical transport network has been evolving rapidly to become more integrated than ever before with packetized data. In fact, there are a host of "next generation" packetized transport services that are specifically designed to provide connectivity for various packet switched protocols and give business customers the ability to link computer networks or connect to the Internet.[84] As previously discussed, the Commission should define the product market so that it encompasses these cutting-edge services and future broadband services that share similar characteristics. The rapid pace of technological change in the market for broadband services creates an environment in which neither the incumbent LEC's or any other competitor is a serious threat to acquire market power. Those broadband services that exist in the market today will be competing with — and potentially supplanted by — new broadband services and technologies that are being introduced on an almost continuous basis.

The next generation packetized transport services are capable of providing connectivity for transmitting a wide variety of protocols — including Frame Relay, ATM, Ethernet, IP, and Multiprotocol Label Switching (MPLS)— in their native format.[85] In other words, traditional Physical (Layer 1) layer transport capability increasingly is being combined with Data Link layer and Network layer capabilities in the network to create *integrated, "data-aware"* broadband networks. The primary customer applications for these services are linking corporate computer networks and connecting to the Internet.

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[84] As previously noted, SBC uses the term "packetized data" to refer generally to data that is formatted as a packet, cell or frame at the Data Link (Layer 2) or Network (Layer 3) layers of the network.

[85] Other common protocols used in computer networks include Fibre Channel, ESCON, FICON, and Infiniband.

The next generation packetized transport services offer customers a number of important benefits because of their ability to transport and interface natively with computer protocols. *First*, these services are now capable of transporting Ethernet protocols over SONET service, which previously was not possible. Ethernet protocols are commonly used by corporations and educational institutions in their computer networks, and the Information Technology personnel who manage those networks are more familiar with computer protocols such as Ethernet than they are with telecommunications protocols such as SONET. Due to competition and technological improvements, business customers increasingly are transporting their metropolitan and long haul data traffic via Ethernet protocols. *Second*, customers can avoid the additional cost of adapting their packetized data for transport and can aggregate data traffic in multiple protocol formats onto a common transport service. *Third*, a customer can purchase appropriately sized bandwidth, rather than possibly being forced to purchase much more capacity than it really needs. For example, without the packet recognition and management capability of a next generation service, a customer that needs only 10 Mbps of bandwidth to meet its peak demand needs would have to purchase *four times* that amount of bandwidth because SBC's closest capacity product is traditional DS3 transport.

The following are some of the next generation services that are being deployed or may be deployed in the near future by SBC and others:

Ethernet. SBC included Gigabit Ethernet in its Non-Dominant Petition, but there actually are a number of different Ethernet services. In addition to Ethernet service with Gigabit capacity, carriers also may offer lower capacity Ethernet services, such as 100 Mbps or 10 Mbps. Additionally, advances in Ethernet services in the metropolitan and long haul markets soon will make 10 Gigabit Ethernet service a reality. Moreover, a carrier may offer Ethernet services as a packet-switched service or as a packetized transport service in which the customer provides its own packet switching. There also are various ways to deliver Ethernet transport services. One type of Ethernet service uses line extenders to significantly extend the reach of Ethernet networks beyond what was previously possible. Recently, a number of vendors have added

protocol recognition features to their SONET equipment that can recognize native Ethernet protocols and facilitate the transport of Ethernet over SONET. All of these services are being developed to respond to the fast-growing demand for Ethernet services in the larger business market segment, which has even spawned a new generation of competitors known as Ethernet LECs (or ELECs).[86]

Multi-Service Optical Network (MON). SBC and other carriers are developing the MON service offering to provide large customers with the ability to connect mainframes or data centers in a point-to-point setting using a wide range of protocols. MON uses a unique Universal Optical Interface that can deliver multiple protocols, which allows customers to efficiently aggregate their data traffic regardless of its native format. In addition, MON currently uses dense wavelength division multiplexing (DWDM) technology to significantly enhance the capability of a customer's existing service using a single pair of fibers. Using DWDM, a customer can purchase a total of 64 service channels, each of which has the equivalent broadband capacity of 2.5 Gigabit service. Thus, the benefits of a MON service are that it supports multiple protocols and provides significant economies of scale for large customers. It also provides customers with a "seamless" infrastructure that is high-speed, reliable, scalable and flexible.

Evolving Technologies. A number of equipment vendors are developing optical switching technologies that may someday supplement or replace packet switches in the provision of future packet-switched services. The creation of the "all optical network" of the future will require such optical switching technologies to be robust in both their capabilities and their placement. Another developing technology is the Resilient Packet Ring (RPR). The standard for RPR, which is currently under development, envisions an optical ring structure carrying vast amounts of packetized data and providing fast, SONET-like restoration capabilities for fiber or

[86] For example, Telseon, and Yipes are both offering Ethernet transport services in 20 Tier 1 cities nationwide.

node failures. These evolving technologies surely will lead to the development of new broadband services.

All of these broadband services for larger business customers rely on similar networks that operate independently from the public switched telephone network and share several key technical characteristics:

- they have the same basic architecture, which consists of equipment that packetizes data into a variety of protocols and equipment that transmits and routes the packetized data, and ultimately will be able to act on information contained in the packet, cell or frame;
- they allow customers to perform traffic management, traffic prioritization, and traffic aggregation of their packetized data;
- they are "always on;"
- these networks typically use diverse routing, which permits highly reliable and secure communications.[87]

Moreover, each of the services in this market segment is used principally for high-speed transmission.[88] As a result of these similar features, the services are interchangeable from a functional standpoint.[89] Larger business customers use each of the broadband services in this market predominantly for the same basic function: to efficiently and reliably transmit data at high speeds between computers or networks of computers using a secure, customer-dedicated network.[90]

Once an incumbent LEC has deployed next generation packetized transport equipment that is capable of recognizing packetized data, the next logical step is to take advantage of this recognition by offering customers broadband services that act on information contained within packets, cells or frames. As such, many of these services fall squarely within the Commission's

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87 *Non-Dominant Petition*, pp. 29-30.

88 *See Non-Dominant Petition*, p. 30, for discussion of service speeds.

89 *See Crandall/Sidak Declaration,* ¶ 99.

90 *Non-Dominant Petition*, p. 31.

definition of an "information service."[91] Therefore, as in the mass-market segment, many broadband services purchased by larger business customers will involve transmission that is integrated with content or an information service functionality. This is an important development in the larger business market segment that the Commission must address in this proceeding and its *Title I NPRM* proceeding.

In short, there are a host of established, emerging and yet-to-be-developed broadband services that are part of the larger business segment of the market. The Commission should define the product market to include all "reasonably substitutable" services that provide larger business customers with high-speed services that are capable of transmitting and routing packetized data in various formats. It should be careful not to define the product market according to any particular technology or network configuration that may be used to provide these capabilities.

E. There Are No Other Relevant Sub-Markets in the Broadband Services Market.

In the *NPRM*, the Commission asks whether "the traditionally identified two broad categories of markets for telecommunications services — the mass market, comprised primarily of residential users and the larger business market, comprised of medium and large business users — are appropriate for incumbent LEC-provided broadband services."[92] Also, in a related question, the Commission asks whether these product markets are "overly broad and should be segmented further."[93] There are no other relevant sub-markets in the broadband services market in addition to the ones identified in SBC's Non-Dominant Petition.

First, the Commission asks whether it should treat wholesale broadband services that are sold as inputs to other firms differently than retail broadband services.[94] There is no need for

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91 47 C.F.R. § 64.702(a).

92 *Id.,* & 20.

93 *Id.*, & 23.

94 *NPRM*, ¶ 24.

government intervention or regulation of wholesale broadband services, any more than there is a need for regulation of retail broadband services. The justification for regulating wholesale relationships is the concern that the market may not function properly if a provider has exclusive control of bottleneck facilities. No such concern exists in the broadband market. As NCTA stated on behalf of the cable industry, no company has bottleneck control over broadband access to the Internet.[95] Instead, "[t]elephone companies, electric utilities, fixed wireless, and satellite providers all are rolling out viable broadband alternatives."[96] Thus, the type of competitive conditions that could warrant wholesale regulation is completely absent in the broadband market.

Further, to the extent the Commission does consider wholesale issues related to the broadband market, it cannot threat if as a "one wire" issue by focusing exclusively on the incumbent LECs' DSL services in this proceeding. Any wholesale regulation of DSL service must apply equally to competing broadband platforms, including cable modem service. Therefore, SBC believes the issue is more appropriately addressed in the context of the pending *Cable NOI* and *Broadband Title I* proceedings, and the Commission should *not* address the issue in the context of this Title II proceeding.

Second, there is no separate sub-market for small business customers. Small business customers are a heterogeneous group, which, as the Commission acknowledges, range from small or home office (SOHO) businesses to small to medium enterprises (SMEs) with multiple locations.[97] This diversity of organizations and business needs means that small business customers do not form a distinct, easily definable market segment. SBC, for example, does not have a distinct category of broadband products that is designed for or used only by small

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95 *The Pitfalls of Government Access: Why Government Regulation of Cable's Broadband Services Would Limit Choice and Forestall Competition*, NCTA (Jan. 2, 2002).

96 *Id.*

97 *NPRM*, ¶ 23. Definitions of who small business customers are can be based on the number of access lines they purchase or the amount of money they spend monthly for telecommunications services or the number of employees they have. There is no single, agreed-upon definition.

business customers. Instead, a SOHO may purchase, from ISPs, DSL service available to residential customers. A SME with multiple locations may purchase low-end frame relay service. The intense competition in the larger business market and mass-market segments ensures that small businesses have access to competitively priced services. Even though cable companies have targeted the residential market, they also are marketing services to business customers.[98] Small business customers also have the option of purchasing traditional DS1 or DS3 service from incumbent LECs or from a host of CLECs that provide service to these business customers. These traditional services will continue to be subject to significant and growing competition, as well as dominant carrier regulation that will ensure the continued availability of reasonably priced service offerings.

Third, the Commission asks commenters to discuss "[t]he extent to which residential customers might view narrowband services as a substitute for broadband services and the extent to which residential customers might substitute lower-speed, circuit-switched services as substitutes for higher-speed broadband services."[99] As SBC demonstrated in its Non-Dominant Petition, SBC contends that narrowband service clearly is not in the same product market as mass-market broadband services. As discussed further below, customers who want and use cable-modem services and DSL services want features, such as higher speeds and an "always on" connection, that are not available with dial-up modem services. While it is certainly true that a significant increase in the price of cable-modem service or DSL service might cause end users to forego the features of broadband service and elect to purchase narrowband service, that does not mean broadband and narrowband services are in the same product market. It is equally possible that the price of owning or operating a passenger car might rise to the point where some drivers would switch over to public transportation. Yet, no one would argue that passenger cars

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98 *See* Comcast's "Comcast Commercial Internet Services":www.comcastbusiness.com/ and Time Warner's "Road Runner Business Class":www.rrnow.com/business/services/cfm# and Time Warner's "Road Runner Pro":www.rrcom/rdrun.

99 *NPRM*, &26.

and city buses are in the same product market. In any event, even if the Commission were to conclude that broadband and narrowband services were part of the same market, the fact that all of the incumbent LECs' narrowband services will remain subject to dominant regulation merely strengthens the case for removing dominant carrier regulation of their broadband services.

IV. Geographic Market Definition

Like long-distance traffic, a high-speed connection to the Internet "at its most fundamental level, involves a customer making a connection from one specific location to another specific location." As with a long-distance voice call, customers do not view broadband connections originating in different locations to be close substitutes for each other. Thus, each point-to-point market represents a separate geographic market for mass-market broadband services. As noted, though, the Commission does not assess competition in every point-to-point market. To the contrary, it will only assess competition in a particular market or group of markets if there is credible evidence that there is or could be a lack of competitive performance in such market(s). In the *BOC Classification Order,* the Commission held that the level of competition could differ inside and outside a BOC's service area. Consistent with that holding, the relevant geographic market for both mass market and larger business broadband services is the nation as a whole. As shown below, there are no other point-to-point markets that require separate analysis.

A. Mass Market Services.

As Crandall and Sidak show, there is no credible evidence that there is any particular point-to-point market or group of point-to-point markets in SBC's territory in which SBC could exercise market power in the provision of DSL transport services. There are more than one dozen providers of cable modem service in SBC's territory. The leading providers all have upgraded the vast majority of their plant so that it is capable of providing cable modem service.[100]

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[100] *See Crandall/Sidak Declaration,* at ¶¶ 43-44.

This data is corroborated by nationwide data. The National Cable and Television Association (NCTA) reported in September 2001 that 83 percent of all U.S. households passed by cable would be upgraded for cable modem service by the end of 2001.[101] This is consistent with a recent analyst report issued by the Yankee Group, which found that, as of year-end 2001, two thirds of all U.S. households would have access to cable modem service and that, by year-end 2002, 77 percent of U.S. households would have access to cable modem service.[102] A more recent report issued by NCTA projects that by the end of 2002, 95.2 million homes (or about 90 percent of homes passed by cable) will have access to cable modem service.[103] In stark contrast, SBC can offer DSL service to about 60 percent of its customers.

Because upgraded cable plant is so ubiquitous, there are likely to be few, if any, customers to whom DSL, but not cable modem, services are available. But even if there are such customers, they would still have other broadband options. For example, they could obtain broadband Internet access service from a satellite or wireless provider. Although satellite technologies still account for a relatively small share of the broadband Internet access market, they are ubiquitously available and growing rapidly.[104] The Strategis Group predicts that the number of U.S. satellite subscribers will grow to more than four million by 2005.[105] To be sure, upload speeds for satellite broadband services are slow, but as Professors Janusz Ordover and Robert Willig have testified on behalf of AT&T, such concerns are "irrelevant to the vast majority of users, who, if they worry about speed at all, are primarily interested in fast download

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101 Downloaded from National Cable Television Association web site on Sept. 25, 2001 at http://www.ncta.com/industry_overview/indStat.cfm?indOverviewID=2.

102 *Yankee Group Broadband Report* at 4.

103 *Cable & Telecommunications Industry Overview 2001*, National Cable & Telecommunications Association (Dec. 2001).

104 *See Crandall/Sidak Declaration,* ¶ 46.

105 *Id.*

times and do not send significant amounts of information."[106] Moreover, many of the consumers to whom cable modem service is unavailable are likely users of satellite video service. Having already chosen a satellite-based service for video, these customers likely would be receptive to satellite service for their Internet access as well.

As for wireless service, that too is increasingly a competitive alternative. Frost & Sullivan projected that there would be over 400,000 fixed wireless broadband subscribers nationally by the end of 2001.Thus, wireless service, like satellite service, "can be expected to fill any niche in which competition between DSL and cable modem service is less vigorous."[107]

B. Larger Business Services.

There also is no credible evidence that there is any particular point-to-point market or group of point-to-point markets in which an incumbent LEC could exercise market power in the provision of broadband services to larger business customers.

First, from a demand-side perspective, customers that purchase broadband services often seek to connect multiple points that are widely dispersed. For example, SBC's average Frame Relay customer orders four PVCs, which means that it uses this service to connect between five and eight different points. SBC's average ATM customer orders two PVCs, which means it uses this service to connect either three or four different points. This is consistent with independent data showing that the average frame relay customer nationwide purchases a total of 12 switching ports, and that the average ATM customer nationwide purchases a total of five switching ports, because there is a close correlation between the number of switching ports a customer purchases and the number of distinct points it wishes to connect.[108] Moreover, many broadband customers seek to connect, not only multiple points within a single LATA, but also points within multiple

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106 *See* Reply Comments of AT&T Corp. and MediaOne Group, Inc., CS Docket No. 99-251, *Declaration of Janusz A. Ordover and Robert D. Willig*, at ¶100 (Sept. 17, 1999).

107 *See Crandall/Sidak Declaration*, ¶ 48.

108 *Id.,* ¶104, *citing* IDC ATM Study at 7.

LATAs or even in foreign countries. Indeed, only 12 percent of all Frame Relay and ATM revenues are from the provision of such services on a purely "local" basis.[109]

Second, from a supply-side perspective, there are no geographic areas in which competition is lacking. As described in more detail below, the three largest providers of packet-switched services to business customers in SBC's region — and, for that matter, in the entire country — are AT&T, WorldCom, and Sprint. Nationwide, these three carriers account for roughly two-thirds of all revenues for packet-switched services provided to business customers.[110] As three carriers routinely state, they have ubiquitous packet-switched services networks that are capable of serving customers anywhere.[111] In addition, numerous other competitive carriers also provide packet-switched services to business customers throughout SBC's region and the nation as a whole.[112]

V. Incumbent LECs Cannot Exercise Market Power in the Mass-Market Segment.

In its Non-Dominant Petition, SBC cited business journals, industry analysts, and competitors to show that, far from being the dominant provider of mass-market broadband services, the incumbent LEC's share of the market pales in comparison to that of the cable-modem service providers.[113] The evidence that has surfaced in the short time since the filing of that petition confirms that analysis.

A. Market Share.

SBC pointed out in its Non-Dominant Petition that, when the Commission determined that AT&T was no longer dominant in the provision of domestic interstate, interexchange

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109 *Id.,* ¶105; IDC Packet Switching Report at 24, 61.

110 *Id.,* ¶ 106.

111 *See* Non-Dominant Petition, p. 37.

112 *See Crandall/Sidak Declaration,* ¶107; New Paradigm Resources Group, Inc., *CLEC Report 2001*, Ch. 13 (14th Ed. 2001) *("CLEC Report 2001").*

113 *See* SBC Non-Dominant Petition, pp. 38-43.

services, AT&T's market share was estimated to be 60 percent.[114] By way of comparison, the *Crandall/Sidak Declaration* shows that SBC's share of the market for mass-market broadband services is only about 30 percent — about half that level.[115] More importantly, SBC's market share is dwarfed by cable modem service providers, which have captured more than two thirds of the broadband Internet access market and are growing faster than SBC's DSL service.

SBC's market share data is corroborated by nationwide market share data for broadband Internet access. According to an August 2001 Commission report on residential and small business high-speed subscribership, there were fewer than 2 million DSL lines in service, but more than 3.5 million cable modem lines in service nationwide as of December 2000.[116] The Commission's most recent report on residential and small business subscribership showed that there were approximately 2.5 million DSL lines in service, but approximately 5 million cable modem lines in service nationwide as of June 30, 2001.[117] Further, as of the third quarter 2001, there were an estimated 6.4 million cable modem subscribers, compared to 3.7 million DSL subscribers.[118] In short, instead of increasing market share, the incumbent LECs continue to lose the battle in the mass market to cable-modem service providers.

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114 *Id*., at p. 41 n. 117, citing ¶ 62 of the *AT&T Reclassification Order*.

115 *See Crandall/Sidak Declaration*, at &54.

116 *See High Speed Services for Internet Access: Subscribership as of December 31, 2000*, Industry Analysis Division, Common Carrier Bureau, FCC, at Table 1 (Aug. 21, 2001).

117 *In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996,* CC Docket No. 98-146, *Third Report*, FCC 02-33, Appendix C, High-Speed Services for Internet Access: Subscribership as of June 30, 2001, Table 3: Residential and Small Business High-Speed Lines (Over 200 kbps in at Least One Direction) (rel. Feb. 6, 2002).

118 *U.S. Cable Modem Market Share by Operator, 3Q01*, IDC (November 2001). These figures are consistent with the NCTA report that, as of November 21, 2001, there were 6.4 million cable modem subscribers.

As SBC demonstrated in its Non-Dominant Petition, while a large market share does not, in itself, show market power, a low market share generally indicates a *lack* of market power. That is because firms with low market share usually cannot affect the price of a product by restricting their output.[119] The Commission recognized this in the *BOC Classification Order* when it noted that the ability to raise one's prices by restricting one's output "usually requires a large market share."[120] Antitrust authorities also have recognized that a low market share is generally indicative of a lack of market power.[121] The indisputable fact is that incumbent LECs are not even close to catching up to their larger cable modem competitors, let alone surpassing them. To the contrary, it appears that cable modem providers are continuing to expand their lead in the market. Thus, the incumbent LECs' relatively low market share is persuasive evidence of a lack of market power because it shows they could not affect the price of their product by restricting output.

B. Demand Elasticity.

High demand elasticity is further evidence of a lack of market power. In the past, the Commission has relied on indirect evidence of demand elasticity. In its petition, SBC offered both indirect evidence and direct quantitative evidence of the price elasticity of demand for mass-market broadband Internet access services.[122] The quantitative evidence was set out in the *Crandall/Sidak Declaration*. That evidence showed that, for every one percent increase in the price of DSL service, demand drops by an amount between 1.184 and 1.462 percent.[123]

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119 *See Crandall/Sidak Declaration,* ¶¶ 57-58.

120 *BOC Classification Order,* ¶ 83.

121 ABA Antitrust Section, Antitrust Law Developments, 213-214 (3d ed. 1992). *See also United States v. Aluminum Co. of America,* 148 F.2d 416-424 (2nd Cir. 1945) (it is doubtful whether a 60 percent market share would constitute a monopoly, and certainly 33 percent is not).

122 *See* SBC Non-Dominant Petition, p. 44.

123 *See Crandall/Sidak Declaration*, && 63-67.

SBC also submitted a substantial body of evidence showing high demand elasticities of the type normally considered by the Commission. This evidence included SBC's DSL churn rate, which is high. SBC's churn rate for DSL service during 2001 was more than 20 percent, which is similar to the churn rate that the Commission found indicative of high demand elasticities in the *AT&T Reclassification Order*.[124]

In addition, SBC cited consumer surveys showing the features that customers seek in choosing a broadband Internet access service platform (*e.g.*, speed, access to high-bandwidth applications, an "always on" connection and the ability to use the telephone while accessing the Internet). The fact that each of these features is available, not just from DSL service, but also from other broadband platforms such as cable-modem service, suggests that there are high cross-elasticities of demand between DSL and the other platforms that offer these features. The evidence presented by SBC also included customer surveys showing that consumers interested in a broadband Internet access service had no preference between a DSL or cable modem platform.[125] These surveys were not specific to SBC's region. The showing made by SBC goes far beyond the evidence that has been available to the Commission in other proceedings in which it found carriers were non-dominant, and it compels a finding that incumbent LECs are non-dominant in the broadband services market.

C. Supply Elasticity.

In its petition, SBC showed that cable-modem service providers could add significant numbers of new customers with their existing capacity and add incrementally to this capacity as new customers are added to their networks.[126] As many as four fifths or more of all homes in the United States are passed by cable facilities that are capable of providing cable-modem service,

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124 *AT&T Reclassification Order*, ¶ 63.

125 *See* SBC Non-Dominant Petition, p. 46, citing both the *Crandall/Sidak Declaration* and YANKEE GROUP, "Residential Broadband: Cable Modems and DSL Reach Critical Mass," March 2001 at Exhibit 12.

126 *Id.*, at p. 47.

and there is no reason to believe the number is any less in SBC's region.[127] According to NCTA, more than 81 million homes were passed by cable-modem service at the end of 2001. Yet only six or seven million of these households will subscribe to cable-modem service at that time. Thus cable operators have facilities in place that will enable them to expand their capacity to meet customer demand *twelve-fold*.

To put this massive capacity in perspective, consider the following: SBC currently provisions about 1.1 million DSL lines. Assuming that one third of the 83 million homes passed by cable-modem service and one third of the 6.5 million or so cable-modem subscribers are in SBC's territory, then cable operators have facilities in place to serve more than 25 million additional customers in SBC territory alone — *i.e.,* 23 times SBC's entire customer base.

To be sure, if cable operators did take on so many new customers, they would eventually have to install additional downstream capacity to avoid degradation in service quality. But additional downstream capacity could be added on an as-needed basis as more and more customers were added, and the incremental cost of this investment, when averaged across all new subscribers, would not be excessive. In fact, cable operators would not be upgrading so much of their plant already if the cost of this capacity was prohibitive.[128]

Of course, the Commission need not theorize on the rate at which cable operators can absorb new subscribers. It can simply look at the facts. Despite a recent slowing of growth, the five largest cable operators alone added more than 600,000 cable-modem subscribers in the second quarter of 2001.[129] Assuming again that one third of these additions were in SBC's territory, then those cable operators added in the ordinary course of business in the equivalent of

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127 *See* Section IV *supra.*

128 *See also Crandall/Sidak Declaration* ¶ 74.

129 "TW Cable Tops AT&T as Biggest High-Speed Provider, Study Shows," Communications Daily, Aug. 17, 2001 at 2 (*citing* report by Warren Communications News' Telecom Research Group).

more than 18 percent of the number of SBC's DSL lines in service in three months. That growth rate alone is more than enough to constrain SBC's pricing of DSL service.

D. Cost, Structure, Size and Resources.

In its petition, SBC demonstrated that it does not enjoy advantages in the market — by virtue of, among other things, its size, financial strength, resources, or cost structure — that are so great as to preclude the effective functioning of the competitive market.[130] It showed, for example, that its principal competitors in the broadband market include such large, well capitalized and mature companies as AOL Time Warner, AT&T and Comcast. Moreover, since SBC filed its Non-Dominant Petition, AT&T and Comcast have announced plans to merge their cable operations and create a company that passes 38 million homes and serves 22 million cable television subscribers.[131] AT&T and Comcast have boasted of the "financial strength and flexibility" of their joint company, as well as its "potential for scaling new and innovative products and services."[132]

Of course as, SBC noted in its Non-Dominant Petition, the Commission need not speculate as to whether SBC and other incumbent LECs enjoy advantages in the broadband Internet access market that could enable them to quickly acquire market power. If the incumbent LECs had such advantages in the market, they already would have acquired market power by now, or at least would be well on their way to doing so. Yet, instead of making headway in this market, the incumbent LECs are losing ground. Moreover, analysts uniformly predict that cable modem service will continue to outpace DSL service through 2005 and beyond.[133]

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130 Non-Dominant Petition, p. 49.

131 AT&T/Comcast Corp: Investor Presentation, p. 7 (Dec. 20, 2001). *See* http://www.att.com/ir/ae/200112/info.html.

132 *See* Non-Dominant Petition, p. 50 n. 143.

133 *Id*., at p. 50.

Indeed, as SBC showed, far from enjoying advantages in the market, incumbent LECs face significant disadvantages. Among other things, DSL service *costs* more to deploy than cable modem service. Studies show that DSL providers face incremental costs of $792 per customer, while cable modem providers face an incremental cost of only $468, and that the average cost per customer of a large incumbent LEC undertaking a massive DSL deployment is currently $86 per month per customer, declining to $38 by 2005.[134] This compares unfavorably to the average, per-month per-customer cost of providing cable modem service, which is estimated to be $55 and projected to decline to $30 by 2005.[135]

Incumbent LECs face other disadvantages in the market. There are significant technological constraints on the deployment of DSL service. An incumbent LEC cannot provide ADSL service to customers whose copper loops exceed 18,000 feet in length without making costly upgrades to its network. Further, incumbent LECs are handicapped by asymmetrical regulatory requirements. For example, incumbent LECs are strictly regulated in the provision of local exchange and exchange access services. Cable operators, by comparison, are largely deregulated and thus are free to cross-subsidize their cable modem deployment with revenue from their cable television operations. In fact, that is exactly what has been happening. The Consumer Federation of America and the Consumers Union recently issued a report showing that since the adoption of the 1996 Act, cable television rates have risen 36 percent, while inflation grew just 14 percent.[136]

VI. Incumbent LECs Cannot Exercise Market Power in the Larger Business Segment

Incumbent LECs also do not possess market power in the provision of broadband services to larger business customers. As demonstrated in its Non-Dominant Petition, SBC is

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134 *Residential Broadband Update*, p. 51

135 *Id.*

136 David Lieberman, *Cable's Rise Fails to Help Elevate Its Stock Values*, USA Today (Feb. 11, 2002).

one of literally dozens of companies competing in the larger business broadband services market today. Its competitors include AT&T, WorldCom, and Sprint, which together, account for about two thirds of all market revenues. In comparison to these firms, SBC is only a minor player in the market. It does not, by a long shot, have the ability to raise prices by restricting its own output.

A. Market Share.

SBC is not the incumbent in the market; it entered the market with zero market share and it competes against larger competitors. As a new entrant, it has deployed all new facilities to provide its services, including hundreds of packet switches and fiber-optic cables to connect them. SBC provides Frame Relay, ATM, and Ethernet services, although it has not yet deployed Ethernet on a widespread basis.

As SBC showed in more detail in the Non-Dominant Petition, its share of combined Frame Relay and ATM revenues is approximately 12 percent.[137] SBC also noted that its share of the larger business market for broadband services is not only low, but also stagnant.[138] The past three year's lack of market share growth proves that SBC has no ability to gain market power. While SBC maintained roughly a 12 percent share of this market throughout this period, the combined market share of AT&T, WorldCom, and Sprint was more than 68 percent of all nationwide Frame Relay revenues and 67 percent of nationwide ATM revenues.[139] Nationwide data is consistent with SBC's market share data. In particular, the four BOCs' share of Frame Relay revenues is 15 percent and their share of ATM revenues is 14 percent.[140]

B. Demand Elasticity.

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137 *See* Non-Dominant Petition, p. 55; *see Crandall/Sidak Declaration,* at ¶112. SBC's market share for these two services is a reasonable proxy for its share of the overall larger business customer's broadband services market.

138 *See* Non-Dominant Petition, p. 55.

139 *Crandall/Sidak Declaration,* ¶¶110-112.

140 *Id.*

As SBC noted in its Non-Dominant Petition, the Commission has long recognized that demand for larger business customers is highly price-elastic based on the fact that customers tend to be very sophisticated and knowledgeable purchasers of telecommunications services.[141] The purchasers of broadband services are among the most sophisticated of all telecommunications consumers. They are almost exclusively large businesses, which typically spend tens of thousands of dollars per year on telecommunications. According to one study, for example, corporate, educational, and government customers account for about 96 percent of Frame Relay revenues, and 82 percent of ATM revenues.[142] The remaining revenues are attributable to other telecommunications carriers.[143]

In addition, these large and sophisticated business customers know their competitive alternatives and shop around before choosing a service provider. Many of them solicit competitive bids from multiple providers through Request For Proposals ("RFPs"). SBC has participated in more than 400 RFPs in the past two years for customers seeking ATM or Frame Relay services. As the Commission has held, the fact that customers "exercise their 'buying power' by soliciting competitive bids before procuring telecommunications services" is evidence that such services are highly demand elastic.[144]

Moreover, larger business customers negotiate long-term contracts that provide significant discounts from carriers' standard rates. For example, in SBC's region the vast majority of all ATM and Frame Relay circuits are provided pursuant to long-term contracts, virtually all of which are for three-year or five-year periods. The fact that such discounted long-term contracts are the norm, proves not only that customers exercise their buyer-power, but also that there is no real possibility that SBC could rapidly gain market power. Since many, if not

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141 *See* Non-Dominant Petition, p. 56.

142 IDC Packet Switching Report, Figure 8, Figure 30, Figure 68.

143 *Id*.

144 *AT&T Streamlining Order* ¶ 37.

most, of its competitors' customers receive service pursuant to long-term contracts, SBC has no ability to compete for those customers at the present time.[145] In a market where customers secure long-term contracts with significant discounts through a competitive bidding process, there is no real possibility that SBC or other incumbent LECs could rapidly gain market power.

C. Supply Elasticity.

Evidence of supply elasticity is equally impressive. In its Non-Dominant Petition, SBC showed that competitors have more than enough excess capacity in their networks to prevent SBC — and presumably other incumbent LECs — from engaging in monopoly pricing.[146] *First*, there are numerous providers of broadband services throughout SBC's region with vast packet-switched networks. AT&T has a domestic network with over 620 Points of Presence (POPs), including multiple POPs in every SBC state.[147] WorldCom and Sprint have similarly extensive networks.[148] And at least 20 other CLECs also provide service in ten or more cities in SBC's region.[149] All told, CLECs have deployed at least 325 packet switches in SBC's region — and perhaps many times that amount.[150] And they also have deployed extensive fiber networks to connect these packet switches.[151]

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145 Most long-term contracts contain termination liabilities for customers that wish to break their contracts, which typically make it uneconomic to do so before the term of the contract has expired.

146 *See* Non-Dominant Petition, p. 58; S*ee also Crandall/Sidak Declaration*, at ¶¶ 117-121.

147 *See* Non-Dominant Petition p. 59.

148 *See Id.*

149 *See Crandall/Sidak Declaration*, ¶ 118. *See also* Non-Dominant Petition p. 59.

150 *CLEC Report 2001* at Ch. 13.

151 In SBC's region, there are at least 34 CLECs with 228 fiber networks in the 61 largest MSAs. *CLEC Report 2001* (13th & 14th eds. 2001); New Paradigm Resources Group, Inc., *CLEC Report 2000* (11th & 12th eds. 2000); New Paradigm Resources Group, Inc., *CLEC Report 1999* (10th ed. 1999).

Second, competitors have rapidly been deploying new switches, proving that providers in this market can rapidly expand their capacity. For example, from 1997 to 2000, the number of competitive packet switches — including those operated by the big three IXCs — has grown by more than 115 percent, from 151 to more than 325.[152] As the Commission has found, "competitors are actively deploying facilities used to provide advanced services to serve certain segments of the market — namely, medium and large businesses."[153] Moreover, the Commission has found that "new suppliers of packet services that do not own transmission facilities may readily enter this market on a resale basis by interconnecting their packet switches and other transmission control equipment with trunks leased from facilities-based carriers."[154]

Finally, the enormous growth in the larger business advanced services market further demonstrates that competitors in this market have additional capacity to constrain the incumbent LECs' pricing. The ATM market has grown by more than 200 percent since 1998, from $344 million in 1998, to over $1 billion in 2000.[155] The Frame Relay market has grown by more than 60 percent since 1998, from $4 billion in 1998, to $6 billion in 2000.[156] The larger business advanced services market as a whole grew by between $2 billion and $3 billion last year, including by approximately $750 million and $1.1 billion in SBC's region. In other words, the larger business advanced services market last year grew by an amount that is somewhere between two-and-a-half and four times the size of SBC's own packet switching revenues. This demonstrates that competitors are deploying more than enough capacity to take away significant business from the incumbent LECs.

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152 *Crandall/Sidak Declaration*, ¶ 119. *See also* Non-Dominant Petition p. 59.

153 *UNE Remand Order,* ¶ 306.

154 *Decreased Regulation of Certain Basic Telecommunications Services*, CC Docket no. 86-421, *Notice of Proposed Rulemaking*, 2 FCC Rcd 645, ¶ 17 (1987).

155 Non-Dominant Petition, p. 60.

156 *Id*.

D. Cost Structure, Size and Resources.

As in the case of the mass-market market for broadband services, incumbent LECs do not enjoy any overall advantages over their competitors with respect to size, resources, financial strength, or cost structure.[157] Again, the incumbent LECs operate with significant *disadvantages* in the larger business broadband services market compared to their facilities-based competitors.[158] These competitors have significant financial strength and resources. AT&T, WorldCom, and Sprint are the nation's three largest long distance carriers, with combined revenues of more than $125 billion – more than two-and-a-half times as large as SBC.[159] In fact, it is these companies' size and strength – as well as their ability to provide packet-switched and interLATA services – that have enabled them to become the largest providers of packet-switched services.[160]

Moreover, because the incumbent LECs are new entrants into the broadband market, they enjoy no advantages of scale over their competitors. As the Commission has stated, "Incumbent LECs and their competitors are both in the early stages of packet switch deployment, and thus face relatively similar utilization rates of their packet switching capacity. . . . It therefore does

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157 *See Crandall/Sidak Declaration,* at ¶¶122-124.

158 SBC notes that, while it has gained the right to offer broadband services on an interLATA basis in six states within its region, it has not come close to acquiring market power in these areas.

159 *Compare* AT&T Corp., Form 10-K (SEC filed Apr. 2, 2001), WorldCom, Inc., Form 10-K405/A (SEC filed Apr. 26, 2001), and Sprint Corp., Form 10-K (SEC filed Mar. 13, 2001) *with* SBC Communications, Inc., Form 10-K (SEC filed Mar. 12, 2001).

160 WorldCom recently stated that its "[r]evenue growth in these fast-growing services continues to lead the industry." WorldCom Press Release, *WorldCom Group Second Quarter 2001 Revenues Up 12 Percent* (July 26, 2001).

not appear that incumbent LECs possess significant economies of scale in their packet switches compared to the requesting carriers."[161]

The incumbent LECs also are and have been disadvantaged by the fact that they cannot offer interLATA broadband services in most areas. The Commission itself has recognized that obtaining "interLATA authority is critical in order to participate in th[e] growing demand for data transmission."[162] At present, SBC can provide interLATA services in only six of its 13 states.[163] Yet, as shown in the Non-Dominant Petition, only 12 percent of all Frame Relay and ATM revenues are from the provision of such services on a purely "local" basis.[164] This fact translates into a large advantage to SBC's competitors. Of course, incumbent LECs that have yet to obtain any interLATA relief are even further disadvantaged.

The incumbent LECs' competitors are making the most of this advantage in the market. As SBC demonstrated in its Non-Dominant Petition, competitors make much of SBC's limitations in this regard in their advertisements.[165] In addition, some of the largest packet-switching providers that provide such services on an interLATA basis, including AT&T, refuse to partner with SBC to offer such services. Their behavior demonstrates the importance of this interLATA advantage to them and highlights the disadvantage to the incumbent LECs.

VII. Incumbent LECs Cannot Leverage Market Power from the Local Market Into the Market For Broadband Services

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161 *UNE Remand Order,* ¶ 308.

162 *In re Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, For Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, CC Docket No. 98-141, *Memorandum Opinion and Order*, 14 FCC Rcd 14712 (1999) (*SBC/Ameritech Merger Order).*

163 These states are Arkansas, Connecticut, Kansas, Missouri, Oklahoma, and Texas.

164 *See* Non-Dominant Petition, p. 61; S*ee also Crandall/Sidak Declaration*, ¶106.

165 Non-Dominant Petition, p. 61.

In addition to asking about an incumbent LEC's ability to raise prices by restricting its output of broadband services, the Commission asks whether an incumbent LEC may be able to raise prices by leveraging market power from the exchange or exchange access markets into the market for broadband services.[166] Clearly, the answer is no. As SBC demonstrated in its Non-Dominant Petition, the fact that incumbent LECs have been competing in the broadband services market for years and have not acquired market power is indisputable proof of their inability to leverage any market power they may have in other markets. In addition, the unique competitive characteristics of the broadband service market will ensure that incumbent LECs do not acquire market power in the broadband services market in the future. Most importantly, the incumbent LECs' primary competitors in the broadband services market have deployed their own networks and thus do not rely on incumbent LEC facilities as inputs for their broadband services in the vast majority of cases. Another important factor is that the incumbent LECs' ability to discriminate or raise their rivals' costs is severely constrained by pervasive regulation of their exchange and exchange access services.

The leveraging issue that the Commission is considering in this proceeding is not novel. In fact, the Commission considered and resolved a similar concern about the use of "local bottleneck facilities" as part of its determination that incumbent LECs are non-dominant in the provision of in-region, long-distance service.[167] Just as an incumbent LEC's local facilities (*e.g.*, the local loop or a special access circuit) may be a component of its broadband services, an incumbent LEC's local facilities are a component of its long-distance service. In addition, broadband services and long-distance services both involve the deployment of extensive new facilities to create an entirely new product. Thus, the Commission's reasoning in support of its conclusions in the *BOC Classification Order* concerns about leveraging market power did not

166 *NPRM*, ¶ 29.

167 *BOC Classification Order*, ¶ 134.

justify dominant carrier regulation of the BOCs' long-distance services is extremely relevant to this proceeding.

In the *BOC Classification Order*, the Commission concluded that applying dominant carrier regulation to the BOCs' long-distance services is "at best a clumsy tool for controlling vertical leveraging of market power by the parent, if the parent can be directly regulated instead."[168] In reaching this conclusion, the Commission considered the fact that anti-competitive behavior could be addressed by other safeguards, such as the complaint process and enforcement of antitrust laws. It also considered the fact that imposing dominant carrier tariff requirements on the BOCs would stifle their incentive to reduce prices and that. Ultimately, the Commission concluded that the benefits of any protections afforded by the dominant carrier tariff requirements were outweighed by the "enormous" administrative burden these requirements would impose on the Commission.[169] These same considerations should lead the Commission to conclude that the benefits of dominant carrier regulation of incumbent LEC broadband services are far outweighed by the costs of such regulation.

The Commission's analysis in the *BOC Classification Order* was limited to determining whether the BOCs could leverage market power in the local market to such an extent that, "upon entry or soon thereafter," they would be able to acquire market power in the market for long distance services.[170] The Commission did not base its decision on whether or not the BOCs might derive some advantage as a result of their existing operations in the local markets. Nor did the Commission base its decision on whether or not the BOCs might have some opportunity to gain an advantage through cross-subsidization or discrimination. The Commission should conduct an equally limited analysis in this proceeding and consider only whether an incumbent LEC could *quickly* acquire market power in the broadband services market.

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168 *Id.,* ¶ 91 (citing DOJ Reply Comments at 27).

169 *Id*., ¶ 128.

170 *Id*., ¶ 103.

As SBC demonstrated in its petition, the broadband services market presents an easier case for the Commission to dismiss leveraging concerns than the long-distance market. The Commission does not have to speculate about whether the incumbent LECs may acquire market power quickly upon entering a new market, as it did in the long-distance market. The incumbent LECs have been competing in the larger businesses segment of the broadband services market for more than ten years and have not increased their market share above 15 percent in all that time.[171] Their competitors continue to have more extensive networks, more customers, and the ability to provide end-to-end interLATA services that incumbent LECs often are not permitted to offer.

Likewise, the incumbent LECs have been competing in the mass-market broadband services market for small business and residential customers for more than two years and continue to lag far behind their larger cable-modem competitors. In fact, the incumbent LECs' competitors enjoy a more favorable cost structure, far more customers, and the freedom to operate virtually free from regulation, including freedom from open access requirements. Moreover, even though SBC operated as a non-dominant provider in the broadband services market for almost two years, it did not come close to acquiring market power. This real-world market data is indisputable evidence that the incumbent LECs cannot leverage market power from other markets into the broadband services market.

Indeed, even as a matter of pure theory or speculation, the incumbent LECs could not leverage market power into the broadband market. The incumbent LECs' primary competitors in the broadband market have deployed their own networks and do not rely on the incumbent LECs for inputs in the vast majority of cases. The presence of much larger inter-modal competitors in both the mass market and larger business segments of the market distinguishes the broadband services market from the market for long distance service, where most competitors

[171] Evidence tendered in support of the Non-Dominant Petition shows that SBC's market share has been stagnant at around 12 percent of the market for the last few years.

continue to utilize the BOCs' local facilities as inputs for their own services. As the Commission recognizes in the *NPRM*, vigorous inter-modal competition reduces the possibility of anti-competitive coordination among competitors.[172] SBC demonstrates below that it does not have the ability to quickly acquire market power by engaging in the particular types of leveraging behavior identified by the Commission.

A. Incumbent LECs Cannot Acquire Market Power by Raising the Cost of Rivals' Essential Inputs.

The Commission seeks comment on whether the incumbent LECs could quickly acquire market power in the broadband services market by charging rivals higher prices for essential inputs.[173] In the context of broadband services, the notion that incumbent LECs could quickly drive their competitors out of the market and keep them (and potential new entrants) out of the market by raising the cost of inputs is patently absurd. In the *BOC Classification Order,* the Commission found that "the entry of a BOC's affiliate into the provision of in-region, interstate, domestic interLATA services might give the BOC an incentive to raise its price for access services to disadvantage its affiliate's rivals, increase its affiliate's market share, and increase the profits of the BOC overall."[174] The Commission found, however, that "price cap regulation of the BOC's access service sufficiently constrains a BOC's ability to raise access prices to such an extent that the BOC affiliate would gain, upon entry or soon thereafter, the ability to raise prices of interLATA services above competitive levels by restricting its own output of those services."[175]

The risk that an incumbent LEC could acquire market power in broadband services through a price squeeze is even lower. In the mass market, as noted above, the incumbent LECs' competitors do not even use incumbent LEC access services to serve their customers. They have

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172 *NPRM*, ¶ 30.

173 *Id.*, ¶ 29.

174 *BOC Classification Order,* ¶ 125.

175 *Id.,* ¶¶ 125-126.

completely separate networks. Thus, a price squeeze is not even a theoretical possibility in that market. Likewise, in the larger business market, the incumbent LECs' competitors often do not use incumbent LEC access facilities. To the extent they do, however, they use special access services that are subject to far more competition than were switched access services at the time of the *BOC Classification Order.* In fact, the special access market has become so competitive that incumbent LECs are exempt from price cap regulation in many areas. In those areas, competitive alternatives deny the incumbent LECs any ability to effect a price squeeze. In all remaining areas, incumbent LECs continues to be subject to price cap regulation in addition to growing competition. Thus, is no possibility that incumbent LECs could acquire market power in broadband services by raising their rivals' costs.

B. Incumbent LECs Cannot Acquire Market Power by Discriminating.

The Commission also seeks comment on whether incumbent LECs could quickly acquire market power by providing rivals with poor quality interconnection, imposing unnecessary delays or engaging in some other type of discriminatory behavior.[176] There is no risk that an incumbent LEC could, through discrimination, quickly acquire market power in broadband services. In the *BOC Classification Order,* the Commission expressed concern that a BOC could "discriminate against unaffiliated interLATA carriers, such as through poorer quality interconnection arrangements or unnecessary delays in satisfying its competitors' requests to connect to the BOC's network."[177] It concluded nonetheless that a BOC could not discriminate "to such an extent that [its] affiliate would gain the ability to raise prices by restricting its own output upon entry or shortly thereafter."[178]

Once again, in the context of broadband services, any risk of discrimination is even more remote. The Commission recognizes that inter-modal competition can reduce the likelihood of

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176 *NPRM*, ¶29.

177 *BOC Classification Order,* ¶111.

178 *Id.*

anti-competitive behavior.[179] Unlike the long-distance market, the mass market for broadband services is characterized by significant inter-modal competition. Indeed, cable operators, which account for more than two thirds of the market, and satellite and wireless providers, which represent a growing presence, do not use incumbent LEC facilities at all. Thus, there is not even a theoretical possibility that the incumbent LECs could engage in unlawful discrimination to such an extent as to acquire market power in this market segment.

Nor is there a risk that the incumbent LECs could acquire market power in the larger business market. As demonstrated above, although incumbent LECs have been providing broadband services to larger businesses for more than a decade, they have not acquired a significant share of this market. To the contrary, the incumbent LECs remain minor players, and the market as a whole is vibrantly competitive. Actual experience in this market, therefore, proves beyond any serious dispute that, even if the incumbent LECs have market power in the provision of local exchange or exchange access services, they have no ability to leverage that power to acquire dominance in the provision of broadband services to larger businesses.

To be sure, incumbent LECs do sometimes provide special access connections from end users to competitors' ports, but they have no ability to acquire market power in broadband services by discriminating in the provision of those connections. In many cases, providers of broadband services to larger businesses do not use incumbent LEC facilities at all to connect to their customers. As of nine months ago, CLECs had deployed 635 local fiber networks in the top 150 metropolitan statistical areas (MSAs) nationally and more than 200,000 local fiber miles.[180] And even when they do use incumbent LEC facilities, their extensive packet-switching capabilities enable them to minimize local access circuit mileage.[181] Thus, unlike long-distance

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179 *NPRM*, ¶ 30.

180 *See* Joint Petition of BellSouth, SBC, and Verizon for Elimination of Mandatory Unbundling of High-Capacity Loops and Dedicated Transport, CC Docket No. 96-98, April 5, 2001 at 3.

181 *See Crandall/Sidak Declaration*, ¶¶ 106, 126.

carriers that, at the time of the *BOC Classification Order,* were largely dependent on BOC switched access services to connect to their long-distance customers, the incumbent LECs' broadband service competitors often do not rely on incumbent LEC facilities to connect to their customers. For this reason alone, the incumbent LECs could not acquire market power in the provision of broadband services to larger business customers through discrimination.

But there are other reasons as well. The Communications Act prohibits unjust and unreasonable discrimination, and there is no doubt that, if an incumbent LEC attempted to discriminate in its provision of special access services to its broadband services competitors in order to acquire market power, that would be a clear violation of the Act.[182] There also is no doubt that, even if an incumbent LEC were foolish enough to attempt to gain market power through discrimination, it would be caught. Because discrimination could only succeed in conferring market power if it affected the purchasing decisions of vast numbers of customers, any attempt to acquire market power through discrimination would be bound to fail. The reason is simple: if large numbers of customers are aware that a carrier's service is deficient in one or more respects, so too will the competitive carrier be aware of that fact. If the deficiency is a result of discrimination, the carrier will promptly bring it to the attention of regulators. As the Department of Justice stated: "[D]iscrimination is unlikely to be effective unless it is apparent to customers. But, if it is apparent to customers, it is also likely to be apparent to regulators or to competitors that could bring it to the regulators' attention."[183] Indeed, discrimination would be apparent to the incumbent LEC's competitors long before it was apparent to their customers. The incumbent LECs' special access carrier customers typically have aggressive vendor management programs by which they regularly, and with great precision, record virtually every aspect of the access services provided to them, including, for example, circuit failure rates,

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182 The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) § 202.

183 Report and Recommendations of the United States Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment, filed Feb. 3, 1987 at 96.

installation intervals and repair intervals. Any customer-affecting service degradation would surely be detected.

In short, the incumbent LECs could not possibly acquire market power by discriminating against competing providers of broadband services to the mass market or larger businesses. Those providers do not even use incumbent LEC facilities, in many cases and to the extent they do, it is inconceivable that they would be unaware of discrimination so rampant that it would enable an incumbent LEC quickly to acquire market power.[184]

VIII. The Costs of Dominant Carrier Regulation of Incumbent LEC Broadband Services Far Outweigh Any Perceived Benefits

In the *NPRM*, the Commission asks a number of questions about the impact that dominant carrier regulation is having on the broadband services market and whether reduced regulation would promote investment and competition in the market. The Commission itself does an excellent job of articulating the urgent need for broadband deregulation. As the Commission acknowledges, the current regulatory requirements that govern the incumbent LECs' provision of broadband services were "developed to address problems created in a one-wire, analog, circuit-switched world.[185] The Commission also recognizes that dominant carrier regulation imposes costs that "can have profound negative implications for consumer welfare" when applied in a competitive environment.[186] Clearly, the Commission is correct. The existing dominant carrier requirements run directly contrary to the Act's goal of promoting the widespread deployment of broadband services to all Americans.

In a series of decisions spanning twenty years, the Commission has repeatedly recognized that forbearance from tariff requirements is appropriate for services provided on a

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184 It also bears noting that, since SBC is not permitted to carry interLATA traffic originating in seven of its thirteen states, it could not acquire market power in its provision of broadband services, even assuming that it could and would engage in rampant undetected discrimination.

185 *NPRM*, ¶ 38.

186 *Id.*

non-dominant basis. It has held that the application of section 203 tariff requirements to such services offers no public benefits, while imposing significant social costs. Conversely, it has held that detariffing of competitively provided services promotes competition and offers other significant benefits to consumers.

These decisions and the reasoning underlying them apply as much to the incumbent LEC's provision of broadband services as to other competitively provided services.[187] Because the incumbent LECs lack market power in the provision of broadband services, they cannot sustain unreasonable rates or practices. Indeed, SBC provided broadband services on a detariffed basis for almost two years and that proved to be the case. During this time, the broadband services market experienced explosive growth. Moreover, far from acquiring dominance in the market, SBC continued to play an unsuccessful game of catch-up with its more dominant competitors.

A. Dominant Carrier Regulation of Broadband Services is Unnecessary

Throughout the past twenty years, the Commission has consistently recognized that the application of section 203 tariff requirements to services provided on a non-dominant basis is wholly unnecessary. For example, in initiating its *Competitive Carrier* proceeding, in 1979, the Commission observed that tariff requirements are not "of any public benefit where firms lacking market power are involved, for [such firms] have no ability or incentive to charge unlawful rates."[188] Based on that finding, the Commission implemented, first, a permissive and then, a mandatory detariffing policy, for non-dominant carriers.[189] In each case in which the Commission applied this policy it concluded that market forces, coupled with the section 208

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187 Non-Dominant Petition p. 74, n. 208.

188 *Id.,* p. 76 n. 212.

189 *Id*., p. 77 n. 213.

complaint process and the Commission's authority to re-impose tariff requirements if necessary, were sufficient to protect the public interest from unjust and unreasonable rates and practices.[190] Without disputing the merits of the Commission's policy determination, the District of Columbia Circuit later held that the Commission, at the time, lacked the authority to forbear from applying section 203 tariff requirements.[191] The Commission responded to this decision by implementing the most minimal tariff regime that could be justified under the statute and reiterating its view that tariff filings by non-dominant carriers are wholly unnecessary:

> On the basis of the extensive record developed in response to the Notice, we now reaffirm our policy findings, adopted nearly a decade ago in Competitive Carrier, and conclude that, while tariff regulation is required by the Act, traditional tariff regulation of nondominant carriers is not only unnecessary to ensure just and reasonable rates, but is actually counterproductive since it can inhibit price competition, service innovation, entry into the market, and the ability of carriers to respond quickly to market trends.[192]

The Commission has continued to adhere to this view in its application of section 10 of the 1996 Act. For example, in the *IXC Forbearance Order*, the Commission found it was "highly unlikely" that carriers lacking market power could successfully charge rates that violate the Communications Act because an attempt to do so would prompt their customers to switch to different carriers.[193] Moreover, the Commission concluded that it could address illegal carrier conduct through the section 208 complaint process. Similarly, in the *CAP Forbearance Order,* the Commission held "[a]s previously determined by the Commission in the *Competitive Carrier Proceeding* and the *IXC Forbearance Order,* tariffing is not necessary to assure reasonable rates for carriers that lack market power. … [I]f access providers' service offerings violate Section 201 or Section 202 of the Communications Act, we can address any issue of unlawful rates

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190 *Id., n. 214.*

191 *Id., n. 215.*

192 *Id*., p. 78 n.216.

193 *Id*., n. 217.

through the exercise of our authority to investigate and adjudicate complaints under Section 208."[194]

This longstanding recognition by the Commission that tariff regulation of non-dominant carriers is unnecessary applies as much to the incumbent LECs' provision of broadband services as to any other service provided on a non-dominant basis. Because the incumbent LECs lack market power in the provision of broadband services, they are in no position to sustain unjust and unreasonable rates or engage in unreasonable practices against any class of customer. To the contrary, if they attempt to raise rates to unlawful levels, or to engage in unreasonable practices, they will lose customers and revenues to their competitors. Subscribers and potential subscribers to DSL service will turn, instead, to other broadband platforms, including, but not limited to, cable modem service. Likewise, customers and potential customers of the incumbent LECs' larger business broadband service offerings will choose AT&T, WorldCom, Sprint, and other carriers that already have considerable advantages in the market. Moreover, in the highly unlikely event that an incumbent LEC did attempt to charge unjust and unreasonable rates or engage in unreasonable practices, the Commission could address the matter through the section 208 complaint process, including accelerated docket procedures.[195] Therefore, the Commission must conclude that tariff requirements are not necessary to ensure that the incumbent LECs' charges, practices, classifications, or regulations for broadband services are just and reasonable and not unjustly or unreasonably discriminatory.[196]

In addition to dominant carrier tariff and pricing requirements, there are other requirements that are adversely impacting realization of the full marketplace potential for broadband services. As previously discussed, broadband services increasingly are integrating

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194 *Id.,* n. 218.

195 *Id.,* p. 79 n. 219.

196 Although, by definition, a non-dominant provider of a service cannot sustain unjust and unreasonable rates or practices, the question posed by section 10 is not whether SBC theoretically *could* do so, but whether tariff requirements are *necessary* to prevent such actions.

transmission with content and information service functionalities. Given this technology integration, however, compliance with existing *Computer Inquiry* requirements becomes problematic and impedes the introduction of new services. These requirements are the product of regulatory regimes that were developed more than 20 years ago in a monopoly circuit-switched telephone market "when very different legal, technological and market circumstances presented themselves" to the Commission.[197] There is no justification for retaining these outdated constraints in the broadband market, where the incumbent LECs are competing against much larger facilities-based competitors.

B. Dominant Carrier Regulation of Broadband Services is Costly and Harmful to Competition.

As the Commission acknowledges in the *NPRM*, the application of dominant carrier regulation imposes direct administrative costs and other costs that "can have profound negative implications for consumer welfare."[198] Chairman Powell expressed a similar view in an interview last May:

> [I]f we don't have a clear and demonstrable justification of a rule, then the appropriate role of government is to take the rule away or not interfere in the otherwise proper functioning of a market, rather than leave a rule in for good measure. Over history a lot of rules that were left for good measure … have secondary effects that often harm the welfare of consumers. … I don't think you've got to prove to me that a rule is not necessary. I think I have to prove that it is necessary. And if I can't do that, I don't think that I should intervene.[199]

But section 203 tariff requirements are not just unnecessary as applied to incumbent LEC broadband services: their application imposes demonstrable social costs and impedes robust competition. The Commission catalogued these costs and the effect of unnecessary tariff requirements on competition in the *IXC Forbearance Order,* the *CAP Forbearance Order,* and

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197 *Title I NPRM*, ¶¶ 35-36.

198 *NPRM*, ¶ 39.

199 *"Powell Defends Stance on Telecom Competition,"* COMMUNICATIONS DAILY, May 22, 2001 at 2-3.

other orders. As the Commission explained in those orders, requiring non-dominant carriers to file tariffs:

- removes incentives for rapid price discounting by giving competitors notice of such discounts;
- reduces or eliminates carriers' ability to make rapid, efficient responses to changes in demand and cost;
- imposes administrative costs on carriers, which must prepare and file tariffs and Commission staff, which must review them; and
- limits the ability of customers to obtain service arrangements that are specifically tailored to their needs.[200]

Each and every one of these costs has been recognized since the *Competitive Carrier* proceeding to be an *inherent* social cost of subjecting firms without market power to tariff requirements. Indeed, in its 1979 Notice of Proposed Rulemaking in that proceeding, the Commission noted that "[t]he advance publication of prices and other terms and conditions — in the context of unregulated industries — has been clearly recognized as anti-competitive."[201]

Significantly, the Commission noted that forbearance is appropriate for *any* firm that lacks market power: "Forbearance discretion, of course, must be exercised upon some well-defined bases which can be measured against the overall statutory goals and mandates of the Communications Act. The lack of market power is, in our view, clearly a sufficient ground upon which to exercise such discretion."[202]

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200 *IXC Forbearance Order,* at ¶ 53, *citing Competitive Carrier Services and Facilities Authorizations Therefore,* Sixth Report and Order, 99 FCC 2d at 1030 and *Implementation of Section 3(n) and 332 of the Communications Act Regulatory Treatment of Mobile Services ,* 9 FCC Rcd 1411, 1479 (1994).

201 *Competitive Carrier Further Notice*, ¶ 87.

202 *Id.*, ¶ 70.

In more recent orders, the Commission has identified still other social costs associated with tariff requirements. For example, in the *IXC Forbearance Order,* the Commission found that tariff filings "may facilitate, rather than deter, price coordination, because under a tariffing regime, all rate and service information is collected in one, central location."[203] In addition, the Commission found, tariffs trigger the application of the filed rate doctrine, thereby effectively denying customers the benefits of state consumer protection and contract laws.[204] In the absence of tariffs, the Commission held, "the legal relationship between service providers and customers will much more closely resemble the legal relationship between service providers and customers in an unregulated environment. Thus, eliminating the filed rate doctrine in this context would serve the public interest by preserving reasonable commercial expectations and protecting consumers."[205]

There are other unique costs imposed by regulation in the broadband context that the Commission has not considered. As previously discussed, broadband equipment in the larger business market segment increasingly is capable of recognizing packetized data in a manner that allows customers to more efficiently combine and transport data traffic of different protocols, and also of acting on content within individual packets of information. Once an incumbent LEC has deployed equipment that this packet recognition capability, the next step is to offer customers new and innovative integrated broadband services that utilize the capability. But this would inherently invoke "computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructure information; or involve subscriber interaction with stored information"[206] As such, many of these new and innovative broadband services would

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203 *IXC Forbearance Order,* ¶ 23. *See also id.,* ¶ 61.

204 *Id.,* ¶¶ 38, 52, 55.

205 *Id.*,¶ 55.

206 47 C.F.R. § 64.702(a).

fall squarely within the Commission's definition of an enhanced or information service and trigger *Computer Inquiry* restrictions.

In a packetized world, it no longer makes sense to require incumbent LECs to segregate their protocol conversion functionality from their transmission services. Moreover, the computer processing restrictions are wholly inconsistent with broadband technology evolution and the potential for new broadband services. Accordingly, the Commission should remove the *Computer Inquiry* requirements that restrict the provision of new and innovative services that are provided using broadband services. Given the intense competition in the broadband market and the rapid pace of technological change it is critical the Commission that remove restrictions that are holding the incumbent LECs back from offering their customers the full range of services and capabilities that are being developed in broadband networks, and that are part and parcel of the broadband market.

In short, as the Commission has long recognized, removing dominant carrier regulation of services provided by carriers that are non-dominant in the provision of those services offers numerous public benefits, not the least of which is increased competition.[207] Here, no less than in these other contexts, forbearance will eliminate unnecessary cost and expense and promote competition. Accordingly, it would be in the public interest for the Commission to forbear from applying dominant carrier regulation, including section 203 tariff requirements and the *Computer Inquiry* requirements, to the incumbent LECs' provision of broadband services.

C. The Commission Can and Should Deregulate Broadband Services.

In addition to asking whether it should remove dominant carrier regulation of the incumbent LECs' broadband services, the Commission asks whether it would be appropriate to implement a new or modified regulatory framework for these services.[208] As discussed above,

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[207] This latter benefit can itself be a basis for concluding that forbearance would be in the public interest.

[208] *NPRM*, ¶ 45.

there is overwhelming evidence that the incumbent LECs' are non-dominant in the provision of broadband services. There is no conceivable justification for failing to deregulate the incumbent LECs in the broadband market, particularly when their larger competitors in the market are effectively deregulated.

Nor is there a need for burdensome structural separation requirements similar to the ones imposed on SBC's broadband services affiliate. SBC incurred significant financial and personnel resources establishing a structurally separate affiliate, and the process of creating a separate affiliate was extremely disruptive to SBC's operations in the in broadband market. In eliminating the structural separation requirement for information services, the Commission concluded that structural separation requirements "impose significant costs on the public decreased efficiency and innovation that substantially outweigh the benefits."[209] In addition, the Commission noted that, as a result of such requirements, "services that would provide valuable benefits to the public may never be offered."[210] For these same reasons, the Commission should not saddle the incumbent LECs' provision of broadband services with the additional costs of unnecessary and inefficient structural separation requirements, particularly when they are the only competitors in the market that must bear such costs.

Moreover, whether or not incumbent LECs are classified as dominant in other markets should have no bearing on the Commission's decision to classify incumbent LECs as non-dominant in the broadband services market. Congress expressly granted the Commission the authority to forbear from regulation with respect to individual services, as well as individual carriers.[211] Further, this would not be the first occasion in which the Commission has classified an otherwise "dominant" carrier as non-dominant in the provision of particular services. In the *LEC Classification Order* the Commission ruled that independent LECs were non-dominant in

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209 *Computer III Order*, 104 F.C.C.2d 958, 964 (1986).

210 *Id.,* at 1003.

211 47 C.F.R. § 160(a).

the provision of interLATA services, even though such carriers are not subject to section 272 separation requirements.[212] In addition, the Commission declared AT&T non-dominant in its provisioning of domestic interLATA services, even though AT&T was still classified as dominant in its provisioning of international services.[213] The Commission also has streamlined and reduced regulations of particular services offered by dominant carriers, just as it would be forbearing from regulating particular services in this proceeding.[214]

Likewise, the unbundling requirements of sections 251 and 252 are irrelevant to the issue of classifying incumbent LECs as non-dominant in the broadband services market. Whatever the scope of the incumbent LECs' unbundling obligation, they will continue to be dwarfed in the broadband market by much larger facilities-based competitors. These inter-model competitors are completely unaffected by the Commission's unbundling requirements.

There is simply no justification for failing to deregulate incumbent LECs in the provision of broadband services. The current regulatory environment, where the incumbent LECs' larger competitors in the broadband services market are completely deregulated, while incumbent LECs are subject to a smothering array of regulations, is indefensible. Chairman Powell has recognized as much. Earlier this year, he stated that the Commission's task is to *deregulate* the provision of DSL by incumbent LECs in order to level the playing field between broadband technologies, not to add regulations to the incumbents' existing burdens. The Chairman explained that the Commission must move to "some degree of less regulation" in the broadband

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212 *LEC Classification Order*, ¶ 7.

213 *AT&T Reclassification Order*, ¶ 2.

214 *See AT&T Streamlining Order***,** 6 FCC Rcd 5880; *see also Pricing Flexibility Order,* 14 FCC Rcd 14221.

market that would be "*not so technology centric.*"[215] "We need these things *harmonized,*" he said. "Otherwise, we're penalizing a competitive technology simply because of its legacy."[216]

In any event, removing dominant carrier regulation of incumbent LEC broadband services still would not create complete symmetry in the Commission's regulation of different broadband platforms. In fact, as far as SBC is concerned, it would simply restore the status quo that prevailed at the time Chairman Powell cited the need to achieve greater symmetry through deregulation. It would nevertheless represent an important and essential first step in the right direction. The Commission should take that step as promptly as possible.

IX. Removing Dominant Carrier Regulation of Incumbent LEC Broadband Services Is an Important First Step in Promoting Broadband Competition and Deployment

The Commission asks whether removal of dominant carrier regulation of incumbent LEC broadband services will promote deployment of broadband services and facilities and increase competition in the provision of such services.[217] The answer is unequivocally yes. Deregulation will benefit customers by forcing *all* providers to compete more vigorously in the market. Therefore, regulatory forbearance will help to fulfill the Commission's mandate under Section 706 of the Act to promote the deployment of broadband services and ensure that such services are offered pursuant to competitive terms and conditions that are attractive to customers. If the section 706 directive that the Commission should promote the deployment of broadband services through *inter alia* regulatory forbearance means anything, surely it must apply here, where the Commission clearly has forbearance authority.

Non-Dominant treatment of the incumbent LECs' broadband services in this proceeding is an important step in furthering the goals of Section 706, but the Commission can and must do much more. As Chairman Powell recently acknowledged, the "grim reality" is that broadband

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215 *Cable Bureau Suggests Regulatory Forbearance for New Services,* COMMUNICATIONS DAILY, Feb. 23, 2001 (emphasis added).

216 *Id.*

217 *NPRM*, ¶ 45.

deployment is extraordinarily expensive and will require an enormous amount of private investment.[218] While the Commission has initiated a number of different proceedings that relate directly to broadband services, it must not lose sight of the need to implement a comprehensive regulatory framework that promotes competition and investment in the broadband market. In particular, the Commission should not allow burdensome unbundling requirements that were designed for the legacy circuit-switched network to incumbent LEC broadband investment. This type of "regulatory creep" depresses incumbent LEC investment in broadband services and distorts the market by bestowing artificially regulatory advantages on certain competitors in the market. The Commission will address that issue in the *Triennial Review* proceeding.

Moreover, any regulation of the broadband market must be competitively and technologically neutral for all providers, regardless of the platforms they have deployed. As Chairman Powell has recognized, definitional battles should not determine the regulatory treatment of broadband services, nor should broadband deployment be treated as a "one wire" problem that is limited to the telephone network. It appears the Commission is going to address this important issue. The Commission has initiated a proceeding to consider the regulatory classification of cable modem services. More recently, the Commission initiated a proceeding that is the "functional equivalent" of the cable modem inquiry to consider the regulatory classification of broadband access to the Internet provided over the traditional telephone network.[219] The net result of these separate proceeding must be a competitively neutral regulatory framework that eliminates the significant disparities that exist today and encourages investment in new products and services that will benefit end user customers. One example of this disparity is the requirement that telephone companies, but not cable companies, wireless carriers or satellite providers, must segregate the telecommunications component of their broadband services and offer it on a stand-alone basis to competitors.

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218 *Title I NPRM,* Separate Statement of Chairman Powell.

219 *Title I NPRM,* ¶ 9.

X. Conclusion

There is overwhelming evidence that incumbent LECs are non-dominant in the provision of broadband services for use by mass-market customers and larger businesses. For the reasons discussed above and in SBC's Non-Dominant Petition, the Commission should expeditiously classify incumbent LECs as non-dominant in the broadband services market and forbear from applying dominant carrier regulation, including tariff, pricing and *Computer Inquiry* requirements, to incumbent LEC broadband services.

Respectfully submitted,

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